2.3 CORPORATE ACCOUNTING

2.3.1 Issue and Forfeiture of share

A company means a company incorporated or registered under the Companies Act, 1956 or under any other earlier Companies Acts.

According to Chief Justice Marshal, "a company is a person, artificial, invisible, intangible and existing only in the eyes of law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence".

A company usually raises its capital in the form of shares (called share capital) and debentures (debt capital.) This chapter deals with the accounting for share capital of companies.

Features of a Company

- **Body Corporate :** A company is formed according to the provisions of Law enforced from time to time. Generally, in India, the companies are formed and registered under Companies Law except in the case of Banking and Insurance companies for which a separate Law is provided for.
- **Separate Legal Entity :** A company has a separate legal entity which is distinct and separate from its members. It can hold and deal with any type of property. It can enter into contracts and even open a bank account in its own name.
- **Limited Liability :** The liability of the members of the company is limited to the extent of unpaid amount of the shares held by them. In the case of the companies limited by guarantee, the liability of its members is limited to the extent of the guarantee given by them in the event of the company being wound up.
- **Perpetual Succession :** The company being an artificial person created by law continues to exist irrespective of the changes in its membership.

  A company can be terminated only through law. The death or insanity or insolvency of any member of the company in no way affects the existence of the company. Members may come and go but the company continues.
- **Common Seal :** The company being an artificial person, cannot sign its name by itself. Therefore, every company is required to have its own seal which acts as official signatures of the company. Any document which does not carry the common seal of the company is not binding on the company.
- **Transferability of Shares :** The shares of a public limited company are freely transferable. The permission of the company or the consent of any member of the company is not necessary for the transfer of shares. But the Articles of the company can prescribe the manner in which the transfer of shares will be made.
- **May Sue or be Sued :** A company being a legal person can enter into contracts and can enforce the contractual rights against others. It can sue and be sued in its name if there is a breach of contract by the company.

Kinds of Companies

(i) **Companies Limited by Shares :** In this case, the liability of its members is limited to the extent of the nominal value of shares held by them. If a member has paid the full amount of the shares, there is no liability on his part whatsoever may be the debts of the company. He need not pay a single paise from his private property. However, if there is any liability involved, it can be enforced during the existence of the company as well as during the winding up.

(ii) Companies Limited by Guarantee : In this case, the liability of its members is limited to the amount they undertake to contribute in the event of the company being wound up. Thus, the liability of the members will arise only in the event of its winding up.

(iii) Unlimited Companies : When there is no limit on the liability of its members, the company is called an unlimited company. When the company's property is not sufficient to pay off its debts, the private property of its members can be used for the purpose. In other words, the creditors can claim their dues from its members. Such companies are not found in India even though permitted by the Companies Act, 1956.

On the basis of the number of members, companies can be divided into two categories as follows :

(i) Public Company : A public company means a company which
- (a) is not a private company,
- (b) has minimum paid up capital of Rs. 5 lakh rupees or such higher paid-up capital, as may be prescribed and
- (c) is a company which is not a subsidiary of a private company.

(ii) Private Company : A private company is one which has a minimum paid up capital of Rs. 1 Lakh rupees or such higher paid-up share capital as may be prescribed and which by its articles :
- (a) restricts the right to transfer its shares;
- (b) Limits the number of its members to fifty (excluding its employees);
- (c) Prohibits any invitation to the public to subscribe for any shares in or debentures of the company.
- (d) Prohibits any invitation or acceptance of deposits from person other than its members, directors and relatives.

Share Capital of a Company

- **Authorized Capital :** Authorized capital is the amount of share capital which a company is authorized to issue by its Memorandum of Association. The company cannot raise more than the amount of capital as specified in the Memorandum of Association. It is also called nominal or Registered capital. The authorized capital can be increased or decreased as per the procedure laid down in the Companies Act. It should be noted that the company need not issue the entire authorized capital for public subscription at a time. Depending upon its requirement, it may issue share capital but in any case, it should not be more than the amount of authorized capital.
- **Issued Capital :** It is that part of the authorized capital which is actually issued to the public for subscription including the shares allotted to vendors and the signatories to the company's memorandum. The authorized capital which is not offered for public subscription is known as 'unissued capital'. Unissued capital may be offered for public subscription at a later date.
- **Subscribed Capital :** It is that part of the issued capital which has been actually subscribed by the public. When the shares offered for public subscription are subscribed fully by the public the issued capital and subscribed capital would be the same. It may be noted that ultimately, the subscribed capital and issued capital are the same because if the number of share, subscribed which subscription has been received. In case it is higher than what is offered, the allotment will be equal to the offer. In other words, the fact of over subscription is not reflected in the books.
- **Called up Capital :** It is that part of the subscribed capital which has been called up on the shares. The company may decide to call the entire amount or part of the face value

of the shares. For example, if the face value (also called nominal value) of a share allotted is Rs. 10 and the company has called up only Rs. 7 per share, in that scenario, the called up capital is Rs. 7 per share. The remaining Rs. 3 may be collected from its shareholders as and when needed.

- **Paid up Capital :** It is that portion of the called up capital which has been actually received from the shareholders. When the shareholders have paid all the call amount, the called up capital is the same to the paid up capital. If any of the shareholders has not paid amount on calls, such an amount may be called as 'calls in arrears'. Therefore, paid up capital is equal to the called-up capital minus call in arrears.
- **Uncalled Capital :** That portion of the subscribed capital which has not yet been called up. As stated earlier, the company may collect this amount any time when it needs further funds.
- **Reserve Capital :** A company may reserve a portion of its uncalled capital to be called only in the event of winding up of the company. Such uncalled amount is called 'Reserve Capital' of the company. It is available only for the creditors on winding up of the company.

Nature and Classes of Shares

Preference Shares : According to Section 85 of The Companies Act, 1956, a preference share is one, which fulfills the following conditions :

(a) That it carries a preferential right to dividend to be paid either as a fixed amount payable to preference shareholders or an amount calculated by a fixed rate of the nominal value of each share before any dividend is paid to the equity shareholders.

(b) That with respect to capital it carries or will carry, on the winding up of the company, the preferential right to the repayment of capital before anything is paid to equity shareholders.

Equity Shares : According to Section 85 of The Companies Act, 1956, an equity share is a share which is not a preference share. In other words, shares which do not enjoy any preferential right in the payment of dividend or repayment of capital are termed as equity/ordinary shares. The equity shareholders are entitled to share the distributable profits of the company after satisfying the dividend rights of the preference share -holders. The dividend on equity shares is not fixed and it may vary from year to year depending upon the amount of profits available for distribution. The equity share capital may be :

(i) With voting rights; or

(ii) With differential rights as to voting, dividend or otherwise in accordance with such rules and subject to such conditions as may be prescribed.

Accounting Treatment of Share Capital

(a) When Application Money is Received :

Bank A/c …Dr.

To Share Application A/c

(Being the application money received on … shares)

(b) When Allotment is Made :

The application money is transferred to Share Capital Account.

Share Application A/c … Dr. (No. of Shares allotted x application money per shares)

To Share Capital A/c

(Being the application money on……………………………….. shares @ Rs…. per share transferred to share capital account)

(c) When Applications are Rejected and Money is Refunded : If some applications are rejected by the directors, the money received on such applications is refunded to the applicants.

The entry will be:

Share Application A/c … Dr.

To Bank A/c

(Being application money on shares returned)

(d) When Allotment Money becomes Due :

Share Allotment A/c Dr. (No. of Shares allotted x allotment money per share)

To Share Capital A/c

(Being allotment money due on shares @ Rs… per share)

(e) When Allotment Money is Received :

Bank A/c

To Share Allotment A/c

(Being allotment money received on… shares @ Rs… per share)

(f) When First Call Becomes Due :

(It is a stage subsequent to allotment)

Share First Call A/c ….Dr (No. of Shares allotted x First call money per share)

To Share Capital A/c

(Being the first call money due on … shares @ Rs… per share)

(g) When First Call Money is Received :

Bank A/c … Dr.

To Share First Call A/c

(Being 1st call money received on … shares @ Rs … per share)

(h) When Second Call Money is Made Due :

Share Second Call A/c ….Dr (No. of Shares allotted x Second call money per share)

To Share Capital A/c

(Being the 2nd call due on … shares @ Rs… per share)

(i) When Second Call Money is Received :

Bank A/c Dr.

To Share Second Call A/c

(Being the 2nd call money received on… share @ Rs… per share)

Similar entries are passed for the remaining calls (if any).

Calls-In-Arrears

If any amount, called in respect of a share, is not paid before or on the date fixed for payment thereof, such amount which is not paid, is called **”CALLS-IN-ARREARS”.** Amount may be called up by the Company either as Allotment Money or Call Money. Thus, in case, any default on account of not sending the call money, is known as **“CALLS-IN-ARREARS”** and separate account i.e.

Calls-in-Arrears Account to be opened. The company can charge interest on all such calls in arrears for the period the amount remains unpaid at the rate of 5% p.a. The total of Calls- in-Arrears is shown in the Balance Sheet as a deduction from the Called up Capital.

Journal Entries				
1	Calls-in-arrears account Dr. To Share allotment Account To Share first call Account To Share Second & Final Call Account (Being various calls outstanding transferred)			
2	Bank account Dr. To Calls-in-arrears account (Being the amount received out of Calls-in-Arrears Account)			

Note : The balance of calls-in-arrears account is shown as a deduction from the called up capital in the liability side of balance sheet.

Calls In Advance

The Money received by the company in excess of what has been called up is known as **"CALLS IN ADVANCE".** A Company may, if authorized by its Articles, accept calls in advance from its shareholders. If such an amount, which has not been called, is received, such amount to be credited to a separate account known as **CALLS-IN-ADVANCE ACCOUNT.**

But this amount which is not called should not be credited to Capital Account. A company may pay interest on such amount received in advance at the rate of 6% p.a. No dividend is payable on this amount. The amount so received will be adjusted towards the payment of calls as and when they become due.

Journal Entries	
(a) When interest is due on calls -in-advance :	
Interest Account	Dr.
To interest on calls-in-advance account	
(b) When interest is paid :	
Interest on calls-in-advance account	Dr.
To bank account	
Alternatvely, instead of (a) and (b) above, the following entry can also be passed:	
Interest on calls-in-advance account	Dr.
To bank account	

Issue of Shares at a Premium

The premium amount is credited to a separate account called **'Securities Premium Account'** and is shown under the title 'Equity and Liabilities' of the company's balance sheet under the head 'Reserves and Surpluses'. It can be used only for the following four purposes as laid down by Section 78 of The Companies Act 1956:

(a) To issue fully paid bonus shares to the extent not exceeding unissued share capital of the company;

(b) To write-off preliminary expenses of the company; and

(c) To write-off the expenses of, or commission paid, or discount allowed on any of the shares or debentures of the company;

The journal entries for shares issued at a premium are as follows:

1. For Premium Amount called with Application money

(a) Bank A/c Dr.

To Share Application A/c

(Money received on application for — shares @ Rs. — per share including premium)

(b) Share Application A/c Dr.
To Share Capital A/c
To Securities Premium A/c
(Transfer of application money to share capital and securities premium account)

2. Premium Amount called with Allotment Money

(a) Share Allotment A/c Dr.
To Share Capital A/c
To Securities Premium A/c
(Amount due on allotment of shares @ Rs — per share including premium)

(b) Bank A/c Dr.
To Share Allotment A/c
(Allotment money received including premium)

3. Premium Amount called with Call Money

(a) Share Application A/c
To Share Capital A/c
To Securities Premium A/c
(Amount due on Ist/2nd call @Rs— per share including premium)

(b) Bank A/c Dr.
To Share Call A/c
(Call money received including premium)

Issue of Shares at a Discount

As a general rule, a company cannot ordinarily issue shares at a discount. It can do so only in cases such as 'reissue of forfeited shares' (to be discussed later) and in accordance with the provisions of Section 79 of the Company. Whenever shares are issued at a discount, the amount of discount is brought into the books at the time of allotment by debiting an account called 'Discount on the Issue of Shares Account'.

The journal entry to be passed for the purpose is as given below:

Share Allotment A/c Dr.
Discount on the Issue of Shares A/c Dr.
To Share Capital A/c
(Amount due on allotment of — shares @ Rs — per share and discount on issue brought into account) Companies Act, 1956.

Forfeiture of Shares

It may happen that some shareholders fail to pay one or more installments, viz. allotment money and/or call money. In such circumstances, the company can forfeit their shares, i.e. cancel their allotment and treat the amount already received thereon as forfeited to the company within the framework of the provisions in its articles. These provisions are usually based on Table A which authorize the directors to forfeit the shares for non-payment of calls made. For this purpose, they have to strictly follow the procedure laid down in this regard.

Following is the accounting treatment of shares issued at par, premium or at a discount. When shares are forfeited all entries relating to the shares forfeited except those relating to premium, already recorded in the accounting records must be reversed.

Accordingly, share capital account is debited with the amount called-up in respect of shares are forfeited and crediting the respective unpaid calls accounts' or calls in arrears account with the amount already received.

Thus, the journal entry will be as follows :

(a) Forfeiture of Shares issued at Par:

Share Capital A/c..........(Called up amount) Dr.

To Share Forfeiture A/c...........(Paid up amount)

To Share Allotment A/c

To Share Calls A/c (individually)

(..... shares forfeited for non-payment of allotment money and calls made)

It may be noted here that when the shares are forfeited, all entries relating to the forfeited shares must be reversed except the entry relating to share premium received, if any. Accordingly, the share capital is debited to the extent to called-up capital and credited to

(i) respective unpaid calls account i.e., calls in arrears and

(ii) share forfeiture account with the amount already received on shares.

The balance of shares forfeited account is shown as an addition to the total paid-up capital of the company under the head 'Share Capital' under title 'Equity and Liabilities' of the Balance Sheet till the forfeited shares are reissued.

Forfeiture of Shares issued at a Premium

If shares were initially issued at a premium and the premium amount has been fully realized, but some of the shares are forfeited due to non-payment of call money, the accounting for treatment forfeiture shall be on the same pattern as in the case of shares issued at par. The important point to be noted in this context is that the securities premium account is not to be debited at the time of forfeiture if the premium has been received in respect of the forfeited shares and the amount of forfeiture shall be excluding premium amount.

In case, however, if the premium amount has not been received, either wholly or partially, in respect of the shares forfeited, the Securities Premium Account will also be debited with the amount of premium not received along with the Share Capital Account at the time forfeiture. This will usually be the case when even the amount due on allotment has not been received.

Thus, the journal entry to record the forfeiture of shares issued at a premium on which premium has not been fully received, will be :

Share Capital A/c Dr.

Securities Premium A/c Dr.

To Share Forfeiture A/c

To Share Allotment A/c

and/or

To Share Calls A/c (individually)

(..... shares forfeited for non-payment of allotment money and calls made)

Note : If Calls in Arrears Account is maintained, calls in Arrears Account is credited and not the Share Allotment and/or Share Call/Calls Accounts.

Forfeiture of Shares Issued at a Discount

Where shares forfeited were initially issued at a discount, the discount applicable to such shares must be cancelled or written back. Hence, the Discount on Issue of Shares Account should be credited at the time of forfeiture. Thus, the journal entry to record the forfeiture will be :

Share Capital A/c Dr.

To Share Forfeiture A/c

To Discount on Issue of Shares A/c

To Share Allotment A/c

To Share Calls A/c

or

To Calls in Arrears A/c

(Forfeiture of ..... shares for non-payment of allotment money and the calls made).

2.3.2 Re-issue of Forfeited Shares

The directors can either cancel or re-issue the forfeited shares. In most cases, they reissue such shares which may be at par, at premium or at a discount.

Forfeited shares may be reissued as fully paid at a par, premium, discount. In this context, it may be noted that the amount of discount allowed cannot exceed the amount that had been received on forfeited shares at the time of initial issue and that the discount allowed on reissue of forfeited shares should be debited to the 'Forfeited Share Account'.

The balance, if any, left in the Share-Forfeited Account relating to reissued Shares, should be treated as capital profit and transferred to Capital Reserve Account.

For Example :

When a company forfeits 200 shares of Rs. 10 each on which Rs. 600 had been received, it can allow a maximum discount of Rs. 600 on their reissue. Assuming that the company reissues these shares for Rs. 1,800 as fully paid, the necessary journal entry will be:

Bank A/c Dr. 1,800

Share Forfeiture A/c Dr. 200

To Share Capital A/c 2,000

(Reissue of 200 forfeited shares at Rs. 9 per share as fully paid)

This shall leave a balance of Rs. 400 in share forfeited account which should be transferred to Capital Reserve Account by recording the following journal entry:

Share Forfeiture A/c Dr. 400

To Capital Reserve 400

(Profit on reissue of forfeited shares transferred)

Buy-back of Shares

When a company purchases its own shares, it is called 'Buy-back of Shares'. Section 77A of the Companies Act, 1956 provides that the company can buy their own shares from either of the following sources

(a) Existing equity shareholders on a proportionate basis

(b) Open Market

(c) Odd-lot shareholders

(d) Employees of the company

The company can buy back its own shares either from the free reserves, securities premium or from the proceeds of any shares or other specified securities. In case shares are bought back out of free reserves, the company must transfer a sum equal to the nominal value of shares bought back to 'Capital Redemption Reserve Account'.

Section 77A of the Companies Act 1956 has laid down the following procedures for buy back of shares :

(a) The Articles of the Association must authorize the company for the buy- back of shares.

(b) A special resolution must be passed in the companies' Annual General Body meeting.

(c) The amount of buy back of shares in any financial year should not exceed 25% of the paid-up capital and free reserves.

(d) The debt-equity ratio should not be more than a ratio of 2:1 after the buy back.

(e) All the shares of buy back should be fully paid-up.

(f) The buy-back of the shares should be completed within 12 months from the date of passing the special resolution.

(g) The company should file a solvency declaration with the Registrar and SEBI which must be signed by at least two directors of the company.

Redemption of Share Capital

Equity shares get dividend at a rate fixed at the Annual General Meeting (AGM) depending on the profit available for a particular year. The rate of dividend also varies from year to year. The preference shareholders contribute capital to the company. According to section 85 of the Companies Act, 1956, persons holding preference shares, called preference shareholders. They are assured of a preferential dividend at a fixed rate during the life of the company.

This type of share- holders carry preferential right over other shareholders to be paid first in case of liquidation of the company. Companies use this mode of financing as it is cheaper than raising debt. The preference shares can be of various types.

These are :

(i) **Redeemable Preference Shares :** A company may issue this type of shares on the condition that the company will repay the amount of share capital to the holders of this category of shares after the fixed period or even earlier at the discretion of the company. Section 80 of the Companies Act, 1956 deals with the redemption of preference shares.

(ii) **Irredeemable Preference Shares :** The preference shares, which do not carry the agreement of redemption are known as irredeemable preference shares.

(iii) **Convertible Preference Shares :** This type of shares enjoys the right to the holder to get them converted into equity shares according to the terms and conditions of the issue.

(iv) **Non-convertible Preference Shares :** The holders of these shares do not enjoy the right to get the shares converted into equity shares. Unless otherwise stated, Preference shares are non-convertible.

(v) **Participating Preference Shares :** The holder of this type of preference shares enjoy the right to participate in the surplus profits, if any, after the equity shareholders have been paid dividend at a rate fixed in the AGM. So the shareholders get additional dividend with their normal dividend.

(vi) **Non-participating Preference Shares :** These shares carry only a fixed rate of dividend without any right to get additional dividend. Unless otherwise stated, the preference shares are non-participating.

(vii) **Cumulative Preference Shares :** The cumulative preference shares carry the right to a fixed amount of dividend. The holders of these shares are entitled to get dividend out of future profit if current year’s profit is insufficient for the same. So, the dividend on these shares accumulates till the final payment.

(viii) **Non-cumulative Preference Share :** In this case the dividend for the shareholders does not accumulate. If there is no sufficient profit, this type of preference shareholders will not get any dividend. In this case, the dividend will be lapsed and there will be no arrear dividend.

Conditions

Before going to redeem the preference shares as per section 80 of the Companies Act, 1956, a company should have to follow the conditions :

(i) There must be a provision in the Articles of Association regarding the redemption of preference shares.

(ii) The redeemable preference shares must be fully paid up. If there is any partly paid share, it should be converted in to fully paid shares before redemption.

(iii) The redeemable preference shareholders should be paid out of undistributed profit/ distributable profit or out of fresh issue of shares for the purpose of redemption.

(iv) If the shares are redeemed at a premium, it should be should be provided out of securities premium or profit and loss account or general reserve account.

(v) The proceeds from fresh issue of debentures cannot be utilized for redemption.

(vi) The amount of capital reserve cannot be used for redemption of preference shares.

(vii) If the shares are redeemed out of undistributed profit, the nominal value of share capital, so redeemed should be transferred to Capital Redemption Reserve Account. This is also known as capitalization profit.

Capital Redemption Reserve Account (CRR)

If the company issues any fresh shares for redemption purpose, the transferred amount will be the difference between nominal value of shares redeemed and the nominal value of shares issued (i.e. amount transferred to CRR = Nominal value of shares redeemed – Nominal value of shares issued). The capital redemption reserve account can be used for issuing fully paid bonus shares.

Journal Entries

When preference shares are redeemed at par :

Redeemable Preference Share Capital A/c ………………Dr.

To Preference shareholders A/c.

When preference shares are redeemed at a premium :

Redeemable Preference Share Capital A/c ………………Dr

Premium of Redemption Preference Share Capital A/c….Dr.

To Preference shareholders A/c.

Adjustment of premium on redemption :

Profit and Loss A/c………………..Dr.

Share Premium A/c ……………….Dr.

To Premium of Redemption Preference Share Capital A/c

Transferring the amount to Capital Redemption Reserve Account :

General Reserve A/c …………….Dr.

Profit and Loss A/c …………….Dr.

To Capital Redemption Reserve A/c

When payment is made to preference shareholders :

Preference Shareholders A/c ……………Dr.

To Bank A/c.

When the fully paid bonus shares are issued :

Capital Redemption Reserve A/c …………….Dr.

General Reserve A/c …………………………..Dr.

Share Premium A/c ……………………………Dr.

Profit and Loss A/c …………………………….. Dr.

To Bonus to Shareholders A/c

Capitalization of profit :

Bonus to Shareholders A/c ………………Dr.

To Equity share capital A/c

Example : Raj Co. Ltd. Issued 50,000 Equity shares of Rs.10 each and 3000, 10% Preference shares of Rs.100 each, all shares being fully paid. On 31.3.08, Profit and Loss Account showed an undistributed profit of rs.50,000 and General Reserve Account stood at Rs.1,20,000. On 2.4.08, the directors decided to issue 1500, 6% Preference shares of Rs.100 each for cash and to redeem the existing preference shares at Rs.105 utilizing as much as would be required for the purpose. Show the journal entries to record the transactions.

Solution :

Date	Particulars	LF	Dr.(Rs.)	Cr.(Rs.)
2018 April 2	10% Preference share capital A/c ....Dr. Premium on Redemption of Preference shares capital A/c.....................Dr. To Preference shareholders A/c (Being amount payable on redemption of 3000 preference shares, with premium of 5%).		3,00,000 15,000	3,15,000
"	Bank A/c ....Dr. To 6% Preference Share Capital A/c (Being the amount received on issue of 1500, 6% Preference shares of Rs.100 each made for the purpose of redemption of preference shares as per Board's Resolution dated............).		150,000	150,000
"	General Reserve A/c ....Dr. To Premium on Redemption of Preference shares capital A/c (Being the amount written off against general reserve)		15,000	15,000
"	General Reserve A/c ....Dr. Profit & Loss A/c ....Dr. To Capital Redemption Reserve A/c (Being amount transferred equal to the difference between the nominal value of shares redeemed and proceeds of new issue).		105,000 45,000	150,000
"	Preference shareholders A/c ....Dr. To Bank (Being the amount due to preference shareholders paid).		315,000	315,000

2.3.3 Valuation of Share

The share capital of a company is divided in two parts.

(a) Preference share

(b) Equity Share capital

The rate of divided on preference share is fixed or predetermined. The rate of dividend on equity share depends on the profitability of the concern in a particular accounting year. If a concern earned high profit, then dividend rate is also high and vice versa.

Need and Purpose of Valuation of Shares

The need for valuation of shares may be felt by any company in the following circumstances :

1. For assessment of Wealth Tax, Estate Duty, Gift Tax, etc.
2. Amalgamations, absorptions, etc.
3. For converting one class of shares to another class.

4. Advancing loans on the security of shares
5. Compensating the shareholders on acquisition of shares by the Government under a scheme of nationalization.
6. Acquisition of interest of dissenting shareholder under the reconstruction scheme, etc.

Factors Influencing Valuation

The valuation of shares of a company is based, inter alia, on the following factors :

1. Current stock market price of the shares.
2. Profits earned and dividend paid over the years:
3. Availability of reserves and future prospects of the company.
4. Realizable value of the net assets of the company.
5. Current and deferred liabilities for the company.
6. Age and status of plant and machinery of the company.
7. Net worth of the company.
8. Record of efficiency, integrity and honesty of Board of Directors and other managerial personnel of the company.
9. Quality of top and middle management of the company and their professional competence.
10. Record of performance of the company in financial terms.

Value of share of a company can be stated in the following ways :

Nominal Value or Par Value : Also referred to as face value or Par value, **nominal value** is the value shown on the face of a security certificate or instrument, including currency. The concept most commonly applies to stock - sand bonds but is especially important to bond and preferred stock investors. The value of each type of share expressed or printed on the share and stated in the article of association of the company.

Market Value : Market value of share of a company means the price at which it can sell or purchased or transferred to others. Market value of share should be more than its face value and Par value.

Cost Value : Cost of value of share for a share- holder means that amount one has to spend to acquire the share. This value includes the market value and the expenses on brokerage etc.

Intrinsic Value : This method is also called as Assets Backing Method, Real Value Method, Balance Sheet Method or Break-up Value Method. Under this method, the net assets of the company including goodwill and non-trading assets are divided by the number of shares issued to arrive at the value of each share.

If the market value of the assets is available, the same is to be considered and in the absence of such information, the book values of the assets shall be taken as the market value. While arriving at the net assets, the fictitious assets such as preliminary expenses, the debit balance in the Profit and Loss A/c should not be considered.

The liabilities payable to the third parties and to the preference shareholders is to be deducted from the total asset to arrive at the net assets. The funds relating to equity shareholders such as General Reserve, Profit and Loss Account, Balance of Debenture Redemption Fund, Dividend Equalisation Reserve, Contingency Reserve, etc. should not be deducted

Method of Valuation of Share

There is neither any provision for the method of valuation of share in the companies act, 2013 nor there is any reference in this matter. Generally, in practice the two methods of valuation of its share.

1. Net Assets Valuation Method, or Net Assets Method or Intrinsic Value Method
2. Yield Valuation Method

3. Fair Value Method
4. Return on Capital Employed Method
5. Price-Earnings Ratio Method

1. Net Assets Valuation Method : Assets Valuation Method is also known as Net Assets or Equity Method. At the same time, the shares are valued on the basis of real internal value of the assets of the company and that is why the method is also termed Intrinsic Value Method or Real Value Basis Method.

Computation of Net Assets		
		Rs.
Net Assets		
Fixed Assets (Market Value)		* *
Investments (Market Value)		* *
Current Assets (Market Value)		* *
Goodwill, if any (Market Value)		* *
Less:		* *
Current Liabilities		
Debentures	* *	
Pref. Share Capital (with arrear Dividend)	* *	
Net Assets/Funds available for Equity Shareholders	* *	—
$\therefore$ Intrinsic Value of each share $= \dfrac{\text{Funds available for equity shareholders}}{\text{Number of equity shares}}$		* *

Or

Net Assets = Share Capital + Reserves and Surplus Revaluation – Loss on Revaluation

(2) Yield-Basis Method : Under Yield method share are valued on the basis of yield or dividend received by the shareholders on their share. Yield valuation method are basically affected by three factors.

(a) Dividend Rate :

Value of Share = Rate of Dividend ÷ Normal rate of return × Paid up value of a share

Rate of Dividend = Amount of Dividend ÷ Total paid up share capital × 100

(b) Actual Earning Capacity :

Calculation of Expected Return :

$$\text{Expected Returns} = \frac{\text{Expected Profits}}{\text{Equity Capitals}} \times 100$$

Calculation of Yield value of share :

$$\text{Value of share} = \frac{\text{Expected Rate}}{\text{Normal Rate}} \times \text{Paid up value of share}$$

(3) Fair Value Method : Investors not only want to earn profit but also prefer security of money invested by them. Hence proper weightage should be given to rate of dividend and intrinsic value of equity of share.

Intrinsic Value : Intrinsic value of equity share of company is found by the "assets valuation method.

Market Value : Market value of the equity share is calculated by the "Yield Valuation Method.

Fair Value : Fair Value of each share is the mean of its intrinsic value and Market Value.

Fair Value Method

- Purely theoretical method of valuation.
- Compromised formula fixing the value of the shares as average of Net Assets Method and Yield Method.
- $\text{Fair Value} = \dfrac{\text{NA Method Value} + \text{Yield Method Value}}{2}$

(4) Return on Capital Employed Method : Capital employed is the sum of stockholders' equity and long-term finance. Alternatively, capital employed can be calculated as the difference between total assets and current liabilities.

Actual Rate of Earning = Profit earned after Tax ÷ Capital Employed × 100

Value of Share = Actual Rate of Earning ÷ Normal Rate of Return × Paid up capital

(5) Price-Earnings Ratio Method : This method is generally used to calculate listed Company Share Value. It uses Earning Per Share (EPS) and Market Price of Share (MPS) to calculate value of share.

PE Ratio is determined as follow- MPS/EPS

Investor can average out PE Ratio Companies in same sector to rule out higher or lower side valuation based on one company data.

Value per share – EPS × P/E Ratio

Whenever Company declare its Quarterly results and EPS, Investor by using particular sector PE Ratio can find Value of Share to take investment decision.

The following particulars of Amber Ltd. as on 31st March, 2018 are available :

1.	1,00,000 Equity Shares of Rs. 100 each fully paid		Rs. 1,00,00,000
2.	10,000 12% Preference shares of Rs. 100 each fully paid		Rs. 10,00,000
3.	Securities Premium	Rs. 11,50,000	
4.	Profit and Loss Account	Rs. 33,58,000	
5.	General Reserve	Rs. 18,85,000	
6.	Current liabilities:		
	Creditors	Rs. 31,20,000	
	Bills Payable	Rs. 10,60,000	Rs. 41,80,000
7.	Average Profit after Tax (for last three years)		Rs. 5,85,000
8.	20% of profit after tax is transferred to General Reserve every year		
9.	Fictitious Assets	Rs. 80,000	
10.	Normal Rate of Return is 10%		

Considering the above information, compute the value of equity share by :

1. Assets Backing method
2. Yield method
3. Fair value method (ignore goodwill)

Solution :

Valuation of Shares	
Particulars	**Rs.**
Net Assets Value Capital Employed	
Equity Capital	1,00,00,000
12% Preference Capital	10,00,000
Reserves and Surplus:	
General Reserve	18,85,000
Securities Premium	11,50,000
Profit & Loss Account	33,58,000
	1,73,93,000
Less: Fictitious Assets	80,000
Net Assets	1,73,13,000
Less: Preference	10,00,000
Net Assets for Equity shareholders	1,63,13,000
Value per share	**163.13**
Yield Method	
Average Profit after Tax	5,85,000
Less: Preference Dividend (10,00,000 × 12%)	1,20,000
	4,65,000
Less: Transferred to General Reserve	1,17,000
	3,48,000
F.M.P. for Equity Shareholders	3,48,000

$$\text{Rate of F.M.P.} = \frac{3,48,000}{1,00,00,000} \times 100 = 3.48$$

$$\text{F.M.P. Value per share} = \frac{\text{Rate of F.M.P.}}{\text{Paid} - \text{Up Equity Capital}} \times 100$$

$$= \frac{3.48}{10} \times 100 = 34.8$$

Rate of F.M.P. × Amount Paid Per Share

N.R.R. = 10%

$$\text{Fair Value} = \frac{\text{Net Assets} + \text{Yield Value}}{2}$$

$$= \frac{(163.13 + 34.8)}{2}$$

$$= \frac{197.93}{2} = 98.965$$

2.3.4 Accounts of Companies in Liquidation

Formation of a company and its existence are regulated by statutory laws and so also the winding up of its existence has to be according to certain set procedure laid down under the Act. The statutory procedure adopted for winding up the statutory existence of the company is known as 'liquidation'. Business of the company is closed and its assets are sold; the money so realised is utilised for paying off the liabilities of the company, and if some surplus is left thereafter, it is distributed among the shareholders of the company as per the provisions of the articles or association of that company.

Methods of Winding Up of Company

According to Section 270 of the Companies Act, 2013, winding up of a company may be in either of two ways :

1. Winding up by the Tribunal
2. Voluntary Winding up :
   (i) By Member's Voluntary Winding up
   (ii) By Creditor's Voluntary Winding up

1. Circumstances in which Company may be wound up by Tribunal

Under section 271 of the Companies Act, 2013 a company may be wound up by the Tribunal in the following circumstances :

1. If the company is unable to pay its debts. A company shall be deemed to be unable to pay its debts in the following circumstances :
   (a) If a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding ₹ 1,00,000 than due, has served on the company, by causing it to be delivered at its registered office, by registered post or otherwise, a demand his hand requiring the company to pay the sum so due and the company has for **twenty one days** thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor.
   (b) If execution or other process issued on a decree or order of any court in favour creditor of the company is returned unsatisfied in whole or in part; or
   (c) If it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts, and in determining whether a company is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the company.
2. If the company has, by special resolutions, resolved that, the company be wound up by the Tribunal, such resolution is generally passed in the cases when in the opinion of the company its functioning is not proper and justified;
3. If the company has acted against the interests of sovereignty and integrity of India, the security of the State, friendly relations with Foreign States, public order, decency or morality.
4. If the Tribunal has ordered the winding up of the company under chapter XIX (Revival and Rehabilitation of Sick Companies)
5. If on an application made by the registrar or any other person authorised by the Central Government, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent an unlawful purpose or the person concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.
6. If the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years.
7. If the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

Statement of Affairs

Where the Tribunal has made a winding up order or appointed the official liquidator as provisional liquidator, unless the Court in its discretion otherwise orders, there shall be made out and submitted to the official liquidator within 21 days from the date of liquidation or of appointment of provisional liquidator a statement as to the affairs of the company in the prescribed form, containing the following particulars:

(i) Assets of the company, stating separately the cash balance in hand and at the bank, and the marketable securities, if any, held by the company;

(ii) Debts and liabilities of the company;

(iii) The names, residences and occupation of its creditors, stating separately the amount of secured and unsecured creditors; and in case of secured creditors, particulars of the securities given whether by the company or an officer thereof, their value and the dates on which they were given;

(iv) The debts due to the company and the names, residences and occupations of the persons from whom they are due and the amount likely to be realised on account thereof;

(v) Such further or other information as may be prescribed, or as the official liquidator may require.

This statement of Affairs is prepared in a set proforma as given on next pages.

On perusal of the proforma it is found that the particulars to be shown in the statement are divided into eight list. For each of the items of list, a schedule is prepared separately and these schedules have to be annexed with statement of affairs. The 8 schedules so prepared are as follows:

1. Assets not specifically pledged as per list A.
2. Assets specifically pledged as per list B.
3. Preferential Creditors as per list C.
4. Debentures with a right of floating charge on the assets of the company as per list D.
5. Unsecured creditors as per list E.
6. Preference shareholders as per list F.
7. Equity shareholders as per list G.
8. Deficiency or Surplus Account as per list H,.

Statement of Affairs and Lists to be Annexed

Statement as to the affairs of.......................Ltd., on the........day of........ 20.........., being the date of winding up order (or order appointing provisional Liquidator or the date directed by the Official Liquidator as the case may be) showing assets at estimated realisable values and liabilities expected to rank:

Assets not specifically pledged (as per list 'A')					Estimated realisable value ₹
Balance at Bank Cash in hand Marketable Securities Trade Debtors Loans and Advances Unpaid Calls Stock-in-trade Work-in-Progress Freehold Property, Land and Building Leasehold Property Plant and Machinery Furniture, Fittings, Utensils etc. Investments other tan Marketable Securities Livestock Other Property viz. ……………… ……………… ………………					
Assets specifically pledged[1] (as per list 'B')	(a) Estimated realisable values ₹	(b) Due to Secured Creditors ₹	(c) Deficiency ranking as unsecured ₹	(d) Surplus carried to last column ₹	
Estimated Surplus from Assets specifically pledged					....
Estimated Total Assets available for Preferential Creditors, Debentureholders secured by a floating charge, and Unsecured Creditors (carried forward)					....
Summary of Gross Assets				₹	
Gross realisable value of Assets specifically pledged				....	
Other Assets				....	
Gross Assets Total ₹				....	

Gross Liabilities ₹	Estimated Total Assets available for Preferential Creditors, Debentureholders secured by a floating charge, and Unsecured Creditors (brought forward)		₹
	Liabilities		
	(to be deduced from surplus or added to deficiency as the case may be)		
....	Secured Creditors (as per lists 'B') to the extent to which claims are estimated to be covered by Assets specifically pledged [item (a) or (b) whichever is less] (insert in Gross Liabilities Column only)		
....	(deduct) Preferential Creditors (as per list 'C')		....
	Estimated balance of assets available for Debenture holders secured by a floating charge and unsecured creditors		
....	(deduct) Debenture holders secured by a floating charge (as per list 'D')		
	Estimated surplus/deficiency as regards Debenture holders Unsecured Creditors (as per list 'E')		
....	Estimated unsecured balance of claims of Creditors partly secured on specific assets brought from (c)		
....	Trade Accounts	....	
....	Bills Payable	....	
....	Outstanding Expenses	....	
....	Bank Overdraft	....	
....	Contingent Liabilities	....	....
	Estimated surplus/deficiency as regards creditors, being difference between :	₹	
	Gross Assets	....	
	and Gross Liabilities	....	....
	Issued and Called up Capital		
	...Preference Shares of ₹...each		
	₹ .....Called up (as per list F)	....	
	.....Equity shares of ₹....each		
	₹ called up as per list (G)	....	
	....	....	
	....	....	....
	Estimated Surplus/Deficiency as regards Members (as per list 'H')		....

These figures must be read subject to the following notes :

1. (f) There is no unpaid capital liable to be called up or,

   (g) The normal amount of unpaid capital liable to be called up is ₹...estimated to produce ₹...which is/is not charged in favour of Debentureholder [strike out (f) or (g)].

2. The estimates are subject to cost of winding up and to any Surplus or deficiency on trading pending realisation of assets.

Description of Lists

List A : Assets not specifically pledged : Only those assets are shown under this head which have not been pledged. In the 'Amount' column of this schedule only the 'Realisable value' of the asset is shown and not its book value. If the call money has not been received in full from the shareholders and there are 'calls in arrears', the estimated amount realisable in this account should also be shown under this head.

List B : Assets Specifically Pledged : Under this head, those assets are shown which have been specifically pledged. These assets may have been pledged with fully secured creditors or with partly secured creditors. The particulars of assets and debts under this head are shown in four columns of amount. In the first column, the estimated realisable value (not the book value) of each asset is shown separately, In the second column, amount payable to secured (fully or partly secured) creditors is shown; Then the amount shown in first column is compared with that shown in second column. If the amount in the first column is less the difference is shown in the third column. On the other hand if the amount in the first column is more, the excess amount is shown in the fourth column. Then, the amounts in the third and fourth columns are totalled. The total in the third column shows that there are unsecured creditors for that much amount, and these are included with the unsecured creditors shown in list E. The total of column four shows the estimated excess of assets over the amount to be paid in full to the fully secured creditors, and it is added to the realisable value of assets in list A; Thus, total estimated realisable value of the assets in found.

List C : Preferential Creditors : Under section 327(1) of the Companies Act 2013, in the event of winding up of a company of the following creditors, are treated as 'preferential creditors' :

(i) All revenues, taxes, cesses and rates due from the company to the Central or State Government or to a local authority at the relevant date, and having become due and payable within the twelve months next before that date, not prior to that. If any rent or tax etc. were due and payable to these institutions prior to the period of last 12 months, the same will not be treated as preferential creditors. For example, suppose the relevant date is 1st January, 2016 and an amount of ₹ 40,000 of Income Tax is due, payable to the Central Government. This includes ₹ 30,000 pertaining to the year 2014-15 for which payment orders were issued on 13 January, 2014. Income Tax ₹ 30,000 has become due and payable with a year prior to 1 January, 2016 therefore it will be treated as 'preferential creditor'; But ₹ 10,000 as Income Tax was due and payable earlier than the aforesaid period of twelve months, so it will not be considered as ''Preferential Creditor.'

(ii) All wages or salary of any employee in respect of services rendered to the company, and due for a period not exceeding 4 months within the 12 months next before the relevant date, but the sum to which priority is to be given under this clause shall not, in the case of any one claimant, exceed such sum as may be notified by the Central Government in the Official Gazette i.e. ₹ 20,000 (per person). Remaining amount (if any) shall be considered as unsecured creditor.

Any amount due in respect to compensation, under the rules of Industrial Disputes Act, 1947, not exceeding ₹ 1,000 (per claimant), is treated as preferential creditor.

(iii) All accrued holiday remuneration becoming payable to any employee, or in the case of his death to any other person in his right, on the termination of his employment before or by the effect of the winding up order or resolution.

Where money is advanced (as loan to the company) by some other person for the payment of liabilities mentioned at (ii) and (iii) above, the person by whom the money was advanced shall be treated as preferential creditor for such amount.

(iv) Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, all amounts due in respect of contribution payable during the twelve months next before the relevant date, by the company as the employer of any persons, under the Employee's State Insurance Act, 1948 or any other law for the time being in force.

(v) Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, all amounts due in respect of any compensation

or liability for compensation under the Workmen's Compensation Act, 1923, in respect of death or disablement of any employee of the company.

(vi) All sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees; maintained by the company.

(vii) The expenses of any investigation held in pursuance of section 210 of the Companies Act, 2013, in so far as they are payable by the company.

The aforesaid preferential creditors have equal rights, i.e. these debts shall rank equally among themselves and be paid in full. If the company has sufficient assets, first these liabilities will be paid in full and then other unsecured creditors, will be paid of the company does not have assets sufficient to make full payment to all the preferential creditors, then in such case, the assets will be divided among all those preferential creditors in the proportion of amounts payable to them.

Overriding Preferential Payments

In the winding up of a company, the following dues shall be paid in priority to all other debts irrespective of anything contained in any other provision of this act or any other law for the time being in force-

(a) Workmen's dues; and

(b) Debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to section 327 pari passu with such dues, shall be paid in priority to all other debts.

It is further provided that the aforesaid debts shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

Preferential Payments

Subject to the provisions of Section 327(1), in a winding up the following amounts shall be paid in priority to all other debts.

(i) All revenues, taxes, accesses and rates due from the company to the central or a state government or to a local authority at the relevant date as defined and having become due and payable within the twelve months next before that date;

(ii) All wages or salary (including wages payable for time or piece work and salary earned wholly or in part by way of commission) of any employee, in respect of services rendered to the company and due for a period not exceeding four months within the twelve months next before the relevant date, subject to the limit specified i.e. shall not, in the case of any one claimant, [exceed such sum as may be notified by the central government in the official gazette.

(iii) Missing

(iv) Unless the company is being wound-up voluntarily merely for the purposes of reconstruction or of amalgamation with another company all amounts due in respect of contributions payable during the twelve month next before the relevant date, by the company as the employer of any persons under the Employees State Insurance Act, 1948 or any other law for the time being in force;

(v) All sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees, maintained by the company;

List D : Debentures with a right of floating charge on the assets of the company : If the debentureholders have a right of floating charge on movable and immovable assets, both, then they will be shown in the list 'D'. If the debentureholders have fixed charge on some specific asset, the same will be shown in the list 'B'.

List E : Unsecured Creditors : If there are any creditors other than the secured (fully or partly) creditors, preferential creditors, and the debentureholders with a right of floating charge on the assets of the company, they will be treated as unsecured creditors and they will be shown in the list 'E'.

After showing the unsecured creditors in the statement of Affairs the deficiency of the company is found on the basis of assets and external liabilities of the company, and the same is shown in the statement under the head 'Estimated Deficiency as regards Creditors'.

List F and G : Share Capital : From the estimated deficiency as regards creditors, it is concluded that whole of the preference share capital and the equity share capital, both have been eroded, and the shareholders will probably get nothing. So, a list 'F' of preference shareholders and list 'G' of equity shareholders are prepared and the amounts of both these lists are added to the amounts of deficiency as regards creditors. The total deficiency thus, obtained is known as 'Deficiency as regards Members'. Detailed particulars of this deficiency are given in the list 'H', which is also known as 'Deficiency or Surplus Account'.

In the statement of Affairs, if there is 'surplus' as regards creditors, it is concluded that after making full payments to unsecured creditors, the remaining amount will be paid first of all to the preference shareholders and thereafter to the equity shareholders. Accordingly, out of the aforesaid surplus, the preference share capital (list F) is adjusted first and after that the equity share capital (list G) is adjusted. It may be that there remains some surplus even after the adjustment of equity share capital. It is known as 'Surplus as regards members'.

In both of the aforesaid cases it must be noted that only the called up amount on preference shares and equity shares is to be shown in the list 'F' and list 'G'. If some 'Calls in arrears' are not realisable, it is subtracted from the called up amount to be shown in the lists.

List H : Deficiency or Surplus Account : Detailed particulars of the deficiency or surplus shown by the statement of Affairs is given in this account or statement. It is also known as list 'H'. It is prepared in the proforma given below :

Deficiency or Surplus Account (List H)

The period covered by this account must commence on a date not less than 3 years before the date of winding up order (or the order appointing Provisional Liquidator, or the date directed by the official liquidator) or, if the company has not been incorporated for the whole of that period, the date of formation of the company, unless the official Liquidator otherwise agrees.

		₹
Items Contributing to Deficiency (or Reducing Surplus) :		
1. Excess (if any) of Capital & Liabilities over Assets on the...19...as shown by balance sheet (copy annexed).		
2. Net dividends and bonuses declared during the period from...19...to the date of the statement.		
3. Net Trading Losses (after charging items shown in note below) for the same period.		
4. Losses other than trading losses written off or for which provision has been made in the books during the same period (given particulars or annex schedule).		
5. Estimated losses now written off or for which provision has been made for the purpose of preparing the statement (give particulars or annex schedule.)		
6. Other items contributing to deficiency or reducing surplus.		
		....
Items Reducing Deficiency (or Contributing to Surplus) :	₹	
7. Excess (if any) of Assets over Capital and Liabilities on the...19...as shown in the Balance Sheet (copy annexed).	....	
8. Net Trading Profits (after charging items shown in note below) for the period from the...20...to the date of statement.	....	
9. Profits and Income other than trading profits during the same period (given particulars or annex schedule).	....	
10. Other items reducing deficiency or contributing to surplus.	....	....
Deficiency/Surplus as shown by statement		....
Note as to Net Trading Profits and Losses :		
Particulars are to be inserted here (so far as applicable) of the items mentioned below, which are to be taken into account in arriving at the amount of Net Trading Profits or Losses shown in this account.		
Provisions for depreciation, renewals or diminution in value of fixed assets.		
Charges for Indian Income Tax and other Indian Taxation on Profits.		
Interest on debenture and other fixed loans, payments to directors made by the company and required by law to be disclosed in the accounts.		
Exceptional or non-recurring expenditure :		
....		....
		....
Less : Exceptional or non-recurring receipts :		....
Balance being other trading profits or losses		....
Net Trading Profit or Losses as shown in Deficiency or Surplus Account above.		

On perusal of the above proforma, it is found that this account is prepared in the form of a statement. It is not divided into Credit and Debit sides. All those items are shown in this account which are responsible for increasing the deficiency or decreasing the surplus of the company, and also those which help in decreasing the deficiency or increasing the surplus. Deficiency Surplus account is divided into two parts. First part is given the heading, 'Items contributing to Deficiency or Reducing surplus'. Under this head, first of all, the excess of capital and liabilities over the assets is shown. Thereafter, the items, due to which the reserves of the company have been diminished, are shown, e.g. distribution of profits, trading losses, estimated losses on realisation of assets, other losses or items which decrease the reserves or increase the deficiency. Heading of the second part is 'Items reducing deficiency or contributing to surplus.' Under this head, all those items are shown which help in increasing the reserves and profits, e.g., internal reserves, trading profit, estimated profit on realisation of assets, other profits, if any.

Difference of the totals of items shown under the two heads gives the deficiency or surplus. If the total of items shown under the first head is more than the total of items under the second head, there is deficiency, otherwise there is surplus.

Illustration : The following items were contained in the balance sheet of a company under liquidation on 31st October, 2014 :

		₹
5% Debentures		26,000
Loan from Bank guaranteed by directors (which was implemented)		39,000
Sundry Trade Creditors (including ₹ 2,000 for local taxes which became due and payable in the year 2012)		1,17,000
Income Tax Assessment Year 2012-13	₹ 3,250	
Income Tax Assessment Year 2013-14	₹ 13,650	
Income Tax Assessment Year 2014-15	₹ 650	17,550
Assessment for 2012-13 was completed on 30.9.2013 and for 2013-14 and 2014-15 on 31.7.2015)		
Employee's Salaries for one month (Including ₹ 1,950 for Managing Director)		5,590

Determine the amount of Preferential Creditors.

Solution : Statement Showing Amount due to Preferential Creditors

Particulars	Amount
Income Tax Assessment Year 2013-14	13,650
Income Tax Assessment Year 2014-15	650
Salary due to Employees (Excluding the Salary due to Managing Director)	3,640
Preferential Creditors	17,940

Notes :

(i) Local taxes ₹ 2,000 became due and payable in the year 2012. This pertains to the period prior to last 12 months from the date of winding up 31 October, 2014. Hence, it is not considered as preferential creditor.

(ii) Income Tax ₹ 3,250 for the assessment year 2012-13 will be considered as unsecured creditor, not preferential, because this amount was due and payable on 30.9.2013 the date which was prior to more than 12 months before the date of winding up of the company.

(iii) Salary payable to the Managing Director has not been treated as preferential creditor under section 327(1) of the Companies Act, 2013.

Illustration : From the following particulars of General Trading Company Limited prepare the Statement of Affairs and Deficiency Account as at 31st March, 2016, the date of winding up order :

	₹
10,000 Equity Shares of ₹ 10 each ₹ 5 per share called up	50,000
10,000 6% Preference Shares of ₹ 10 each fully paid	1,00,000
Calls in arrears on Equity Shares (Estimated to produce ₹ 1,000)	2,000
5% First Mortgage Debentures secured by a floating charge upon the whole of the assets of the company exclusive of uncalled capital	75,000
Fully Secured Creditors (Value of Securities ₹ 17,500)	15,000
Partly Secured Creditors (Value of Securities ₹ 5,000)	10,000

Preferential Creditors for Rates, Taxes and Wages etc.	3,000
Bills Payable	50,000
Unsecured Creditors	35,000
Bank Overdraft	5,000
Bills Receivable	7,500
Bills Discounted (One bill for ₹ 5,000 known to be bad)	20,000
Book Debts :	
Good	5,000
Doubtful (estimated to produce 50 paise in the rupee)	3,500
Bad	3,000
Land and Building (estimated to produce ₹ 50,000)	75,000
Stock in trade (estimated to produce ₹ 20,000)	25,000
Machinery, Tools etc., (estimated to product ₹ 1,000)	2,500
Cash in hand	50
Statement of Profit and Loss (Dr.) including ₹ 96,000 loss after 31 March, 2013	1,96,950

Solution : Statement of Affairs of General Trading Company Limited

On 31st March, 2016 the date of winding up order

(Showing Assets at estimated realisable values and Liabilities expected to rank)

<table>
<tr><td colspan="5">Assets not specifically pledged (as per list A)</td><td>Estimated Realisable values (₹)</td></tr>
<tr><td colspan="5">Cash in hand</td><td>50</td></tr>
<tr><td colspan="5">Bills Receivable</td><td>7,500</td></tr>
<tr><td colspan="5">Book Debts</td><td>6,750</td></tr>
<tr><td colspan="5">Unpaid Calls</td><td>1,000</td></tr>
<tr><td colspan="5">Stock in Trade</td><td>20,000</td></tr>
<tr><td colspan="5">Land & Buildings</td><td>50,000</td></tr>
<tr><td colspan="5">Machinery & Tools etc.</td><td>1,000</td></tr>
<tr><td>Assets specifically pledged (as per list B)</td><td>(a) Estimated Realisable values</td><td>(b) Due to Secured Creditors</td><td>(c) Deficiency ranking as unsecured</td><td>(d) Surplus Carried to last column</td><td></td></tr>
<tr><td></td><td>₹</td><td>₹</td><td>₹</td><td>₹</td><td></td></tr>
<tr><td>Securities</td><td>17,500</td><td>15,000</td><td>–</td><td>2,500</td><td></td></tr>
<tr><td>Securities</td><td>5,000</td><td>10,000</td><td>5,000</td><td>–</td><td></td></tr>
<tr><td></td><td>22,500</td><td>25,000</td><td>5,000</td><td>2,500</td><td></td></tr>
<tr><td colspan="5">Estimated surplus from assets specifically pledged</td><td>2,500</td></tr>
<tr><td colspan="5">Estimated total assets available for Preferential Creditors, Debentureholders with floating charge and Unsecured Creditors</td><td>88,800</td></tr>
<tr><td colspan="4">Summary of Gross Assets :</td><td>₹</td><td></td></tr>
<tr><td colspan="4">Gross realisable value of assets specifically pledged</td><td>22,500</td><td></td></tr>
<tr><td colspan="4">Other Assets</td><td>86,300</td><td></td></tr>
<tr><td colspan="4">Gros Assets</td><td>1,08,800</td><td></td></tr>
</table>

Gross Liabilities	Liabilities		Amount (₹)
₹	Estimated Total Assets available for Preferential Creditors, Debenture holders with a floating charge and unsecured creditors brought forward.		₹ 88,800
20,000	(To be deducted from Surplus or added to deficiency as the case may be) Secured Creditors (as per list B) to extent to which claims are estimated to be covered by Assets specifically pledged		
3,000	Preferential Creditors (as per list C)		3,000
	Estimated balance of Assets available for Debentureholders with floating charge and unsecured creditors		85,800
75,000	Debentureholders secured by a floating charge (as per list D)		75,000
	Estimated surplus as regards debenture holders.		10,800
	Unsecured Creditors (as per list E)	₹	
5,000	Unsecured balance of Partly Secured creditors	5,000	
50,000	Bills Payable	50,000	
35,000	Unsecured Creditors	35,000	
5,000	Bank Overdraft	5,000	
5,000	Bills discounted	5,000	1,00,000
	Estimated Deficiency as regards Creditors being the difference between :	₹	
	Gross Assets	1,08,800	
1,98,000	and Gross Liabilities	1,98,000	89,200
	Issued and Called up Capital :		
	10,000 Preferenece Shares of ₹ 10 each (as per list F)	₹	1,00,000
	10,000 Equity Shares of ₹ 10 each ₹ 5 paid up (as per list G)	50,000	
	Less : Calls in Arrears (irrecoverable)	1,000	49,000
	Estimated Deficiency as regards members (as per list H)		2,38,200

List H – Deficiency Account

Items Contributing to Deficiency (or Reducing surplus) :		₹
Excess of Capital and Liabilities over assets on 31st March, 2013 as shown by Balance Sheet		1,96,950
Net dividends and bonuses declared during the period (1-4-13 to 31-3-16)		
Net trading losses during the period (1-4-13 to 31-3-16 ₹ 96,000)		
Losses other than trading losses written off		
Estimated losses now written off on account of realisation of :	₹	
Book Debts	4,750	
Stock in Trade	5,000	
Land & Buildings	25,000	
Machinery & Tools etc.	1,500	36,250
Estimated Loss on account of liability for bills discounted		5,000
		2,38,200
Items reducing De?ciency (or Contributing to Surplus)		....
Deficiency as shown by Statement of Affairs		2,38,200

2.3.5 Acquisition

Whenever any running business is purchased by any newly established company it is known as 'Purchase of Business.

Ascertainment of Purchase Consideration

As mentioned above, purchase consideration is the amount payable by the purchaser of business to vendor in consideration of purchase of business. It can be decide by following two methods :

1. Net Payment Method : According to this method purchase consideration is equal to amount paid by purchaser in consideration of purchase of business which also includes shares or debentures issued by purchasing company. Following points are very important in this regard :

(a) If purchase consideration is paid in cash only, then amount paid by purchasing company will be treated as purchase consideration. For example : purchaser paid ₹ 25,00,000 for the business then purchase consideration is ₹ 25,00,000.

(b) If in addition to cash, shares and debentures are also issued by purchasing company then total of cash, shares and debentures will be treated as purchase consideration.

For example if Ram Ltd. purchased the business of Ram and Shyam (a partnership firm) and it was decided between them that following sum will be paid to them—

(i) 1,00,000 Equity Shares of ₹ 10 each at a price of ₹ 25;

(ii) 10,000 10% Debentures of ₹ 100 each at par; and

(iii) ₹ 1,00,000 in cash.

In this case purchase consideration will be ₹ 36,00,000 calculated as under :

Shares : (1,00,000 × 25) + Debentures : (10,000 × 100) + Cash ₹ 1,00,000.

(c) If any amount is paid to owners and financiers of vendor company then purchase consideration will be equal to total amount payable to owners and financiers of business of vendor company. If in the above illustration, purchaser company agrees to issue :

(i) 40,000 shares of company @ ₹ 25 and 4,000 debentures @ ₹ 100 to Ram;

(ii) 60,000 shares of company @ ₹ 25 to Shyam; and

(iii) ₹ 1,00,000 in cash and 6,000 debentures of ₹ 100 each to meet their liabilities, the purchase consideration will be ₹ 36,00,000 as under :

Ram : (40,000 × 25) + (4,000 × 100)	= ₹ 14,00,000
Shyam (60,000 × 25)	= ₹ 15,00,000
Financiers : (6,000 × 100) + ₹ 1,00,000	= ₹ 7,00,000

2. Net Assets Method : If no purchase consideration has been decided between purchaser and seller or only part of it has been decided, then purchase consideration can be decided by net assets method. For example, if Satya Ltd., is formed to purchase business of Satya (an individual) and purchase consideration is not decided but only It is decided that, It will be paid in 1,00,000 Equity Shares of ₹ 10 at ₹ 25,10,000 Debentures of ₹ 100 at par and balance will be paid in cash."

In this case, purchase consideration has not been decided as it is not mentioned how much cash will be paid. It can be decided by deducting total liabilities out of total assets. Thus, purchase consideration will be equal to net assets. Amount to be paid in cash can be decided by deducting amount of equity shares and debentures out of purchase consideration.

Computation of Net Assets

Net Assets can be computed by deducting agreed amount of liabilities out of revalued price of assets. If revaluation of assets and liabilities is not given, both should be taken at book value.

Net Assets = Total of assets of vendor taken over at revalued price. (If revalued price is not given then book value). Less Total of Liabilities of vendor taken over at revalued price (if revalued price is not given then book-value).

Illustration 1 : Following is the Balance Sheet of Smith and Sons as at 31st March, 2018 :

Balance Sheet as at 31st March, 2018

Liabilities	₹	Assets	₹
Capital :		Building	4,20,000
P. Smith	4,00,000	Plant and Machinery	3,30,000
M. Smith	3,00,000	Investment : 20,000 Equity	
General Reserve	1,00,000	Shares of Black Ltd	2,20,000
Loan : P. Smith	1,20,000	Debtors	80,000
Mrs. M Smith	80,000	Stock	80,000
Creditors	2,00,000	Bank	40,000
		Deferred Revenue Expenditure	30,000
	12,00,000		12,00,000

On the above date Smith Ltd. acquired the business of Smith and Sons. Calculate the amount of purchase consideration.

What would be purchase consideration if :

(i) Investments, Debtors and Creditors are not taken over by purchasing company.

(ii) Building is revalued at ₹ 7,00,000 and Plant and Machinery at ₹ 3,00,000.

Solution :

Computation of Net Assets or Purchase Consideration

	Total of Assets Taken Over :			₹
	Buildings			4,20,000
	Plant and Machinery			3,30,000
	Investments			2,20,000
	Debtors			80,000
	Stock			80,000
	Bank			40,000
			Total Assets	11,70,000
Less :	Total of Liabilities taken over :		₹	
	Creditors		200,000	
	Mrs. M. Smith's Loan		80,000	
	P. Smith's Loan		1,20,000	4,00,000
		Net Assets or Purchase Consideration		7,70,000

(i) If Investments, Debtors and Creditors are not purchased by purchaser, purchase consideration will be :

	₹
Total of Assets taken over excluding debtors and investment	8,70,000
Less : Total of Liabilities excluding creditors	2,70,000
Net Assets or Purchase Consideration	6,70,000

(ii) If building, plant and machine are revalued purchase consideration will be as follows :

	Total of Assets at Revalued Price :			₹
	Building			7,00,000
	Plant			3,00,000
	Investments			2,20,000
	Debtors			80,000
	Stock			80,000
	Bank			40,000
			Total Assets	14,20,000
Less :	Liabilities taken over :		₹	
	Creditors		200,000	
	Mrs. M. Smith's Loan		80,000	
	P. Smith's Loan		1,20,000	4,00,000
		Net Assets or Purchases Consideration		10,20,000

Note :

(1) When it is mentioned that business is purchased, it includes whole of the assets and liabilities except fictitious assets and reserves.

(2) In the absence of other information it is assumed that assets and liabilities are purchased at their book value.

Value of Goodwill : Every business has its own goodwill but it is not shown in the Balance Sheet unless it is purchased. If purchaser and vendor have decided value of goodwill, it will be included in the assets to find out purchase consideration by net assets method. If it is not decided it is equal to excess of purchase consideration by net payment method over net assets.

Note : If net payment is more than net assets it is goodwill but if net payment is less than net assets it is Capital Reserve. For example, if net assets are ₹ 7,70,000 but net payment is ₹ 8,20,000 then difference of it ₹ 50,000 is goodwill.

Good will = Purchase Consideration - Net Assets

Capital Reserve : If net payment is less than net assets, difference is shown as capital reserve in the books of purchaser. For example, if net assets are ₹ 7,70,000 but net payment is ₹ 7,00,000 then difference between both, i.e., ₹ 70,000 will be capital reserve.

Capital Reserve = Net Assets - Purchase Consideration

Note : Either there will be goodwill or capital reserve, both can not arise in the same question.

Journal Entries in the Books of Purchaser

When assets and liabilities are purchased :

Sundry Assets a/c Dr. (Show each asset separately at purchase price)
To Sundry Liabilities a/c (Show each liability separately at purchase price)
To Vendor's a/c (By purchase consideration)
(Sundry assets and liabilities taken over and purchase consideration due.)

Note : If total of Debit side is short, balance amount will be shown in the Debit side as Goodwill. If total of Credit side is short, balance amount will be shown as Capital Reserve in Credit side.

When final amount is paid to vendor. :

Vendor's a/c Dr. (By purchase consideration)
To Equity Share Capital a/c
To Preference Share Capital a/c

To Debentures a/c

To Bank a/c

(Purchase consideration discharged.)

Note :

(1) If shares and debentures are issued at premium then Shares or Debentures a/c will be credited by nominal value and Securities Premium a/c will be credited by premium. If Debentures are issued at Discount, then Discount on issue of debentures a/c will be debited and in that case also Debentures a/c will be credited at nominal value.

(2) If any shares or debentures are issued to public also, separate entries will be passed for it.

(3) If there is any delay in payment to vendors, interest will be paid to vendors and following entry will be passed :

Interest to Vendor a/c Dr.

To Bank a/c

(Being interest paid for delay in payment of purchase consideration.)

Debtors and Creditors not Taken Over by the Company

Sometimes purchasing company does not take debtors, Bills Receivables, creditors and Bills Payable of vendor company because recovery from debtors / Bills Receivables and liabilities of creditors / Bills Payable is not certain. In such situation debtors / Bills Receivables and creditors / Bills Payable are not considered at the time of deciding purchase consideration and no entry is passed for debtors / Bills Receivables and creditors / Bills Payable. Sometimes purchaser may agree to collect money from debtors / Bills Receivables and can make payments to creditors / Bills Payable on behalf of vendor. Purchaser can also charge any commission for providing such service. Following entries will be passed in the books of purchasing company in this regard :

(i) When responsibility of collecting Debtors / Bills Receivables is takeover.

Vendor's Debtors/Bills Receivables a/c Dr.

To Vendor's Suspense a/c

(Being vendors Debtors/Bills Receivables taken into account.)

(ii) When responsibility of making payment to Creditors/Bills Payable is takeover :

Vendor's Suspense a/c Dr.

To Vendor's Creditors/Bills Payable a/c

(Being vendors Creditors/Bills Payable taken into account.)

(iii) When any amount is recovered from Vendor's Debtors / Bills Receivables :

Bank a/c Dr. [Actual cash received}

Vendor's Suspense a/c Dr. [Discount, bad debts, expenses of realisation]

To Vendor's Debtors/Bills Receivables a/c, [Total accounts cleared]

(Being amount recovered from Vendor's Debtors/Bills Receivables.)

(iv) When any amount is paid to Vendor's Creditors / Bills Payable :

Vendor's Creditors/Bills Payable a/c Dr. [Total accounts cleared]

To Bank a/c [Actual cash paid)

To Vendor's Suspense a/c [Discount received]

(Being Vendor's Creditors/Bills Payable paid off.)

(v) When any amount is paid to Creditors / Unrecorded Liability not shown in books :

Vendor's Suspense a/c Dr. [Vendor's unrecorded creditors/Liability paid off]

To Bank a/c

(Being Vendor's Unrecovered Creditors/Liabilities paid off.)

(vi) If any amount is received from any debtor which was not shown in the books :

Bank a/c Dr.

To Vendor's Suspense a/c

(Being amount received from Vendor's Unrecorded Debtors.)

(vii) When commission is accrued to purchasing company :

Vendor's Suspense a/c Dr. [Amount of commission accruing]

To Commission a/c

(Being Commission charged on amount realised and paid on behalf of Vendor.)

(viii) If amount received is more than amount paid and balance amount is paid to vendor :

Vendor's Suspense a/c Dr. [Net amount payable to vendor]

To Bank a/c

To Share Capital a/c [If shares issued]

(Being Vendor's account settled.)

(ix) If amount paid to Creditors is more than amount received from Debtors and balance amount is received from vendor :

Bank a/c Dr. [Net amount Received]

To Vendor's Suspense a/c

(Being amount received from Vendor.)

Alternative Method to Record Such Transactions :

(i) No entry will be passed to take responsibility of collecting from Debtors / Bills Receivables or making payment to Creditors / Bills Payable.

(ii) Following entry will be passed when amount in recovered from Debtors / Bills Receivables of vendors :

Bank a/c Dr. [Net amount realised]

To Vendor's Adjustment a/c

(Being amount realised from vendor's debtors / Bills Receivables.)

Note : No entry will be passed for discount allowed, bad debts and realisation expenses of vendor.

(iii) Following entry will be passed when any amount is paid to Creditors / Bills Payable of vendor :

Vendor's Adjustment a/c Dr. [Total amount paid]

To Bank a/c

(Being amount paid to Vendor's Creditors/ Bills Payable)

Note : No entry will be passed if any rebate or discount received from Vendor's Creditors.

(iv) If any commission is accrued for providing such service :

Vendor's Adjustment a/c Dr.

To Commission a/c

(Being commission due from vendor.)

(v) For making final payment to vendors :

Vendor's Adjustment a/c Dr.

To Bank a/c

(Being final amount paid to vendor.)

(vi) If amount paid on behalf of vendor to its creditors exceeds amount from debtors of vendor and balance amount is received from vendor :

Cash/Bank a/c Dr.

To Vendor's Adjustment a/c

(Being amount received from vendor.)

Profit or Loss Prior to Incorporation

According to the Companies Act, 2013 a company comes into existence only from the date on which Certificate of Incorporation' is obtained by it. If any company has purchased a running business and certificate of incorporation is obtained later on, then profit earned till the date of such certificate will be known as profit prior to incorporation.

For example if a company purchased a running business as on 1 July, 2017 and opened new books on the same date, obtained certificate of incorporation as on 1 Nov., 2017. If company prepared its Statement of Profit & Loss on 31st March, 2018, then profit from 1st July, 2017 to 31st Oct., 2017 will be known as profit prior to incorporation.

2.3.6 Amalgamation of Companies

In General Terms when two or more companies engaged in similar nature of business join together and form a new company for running the business is called "amalgamation of companies". Now this concept has been classified in two broad categories.

In the first category the assets and liabilities of transferor company is taken over but the transferee company but is maintain the interests of shareholders of transferor company and the assets, liabilities, capital and reserve are to incorporated in the accounts of transferee company. This type of amalgamation is called as Merger.

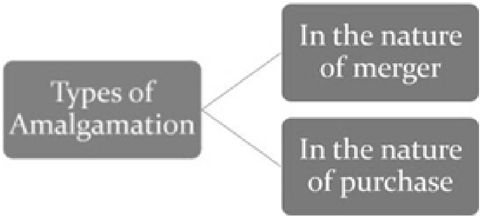
In the secondary category the assets and liabilities of transferor company are taken over by transferee company which results in closing down business of the transferor company and the shareholders of transferor company do not have any interest in the capital of transferee company. This type of amalgamation is known as "purchase"

A combination can be formed in many ways but the following method are much in use :

- Amalgamation
- Absorption
- External Reconstruction

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	Two or More companies are wound up and a new company is formed to take over their business.	In this case an existing company takes over the business of one or more existing companies	In this case a newly company formed takes over the business of an existing company.
Minimum number of Companies involved	At least 3 companies are involved.	At least 2 companies are involved.	Only 2 companies are involved.
Number of new resultant companies	Only one resultant companies are formed two companies are wound up to form a single resultant companies.	No new resultant companies are formed	Only one resultant company is formed under this case a newly formed company takes over the business of an existing company.
Objective	Amalgamation is done to cut competition & reap the economics in large scale.	Absorption is done to cut competition & reap the economics in large scale.	External reconstruction is done to recognised the financial structure of the company.
Example	A ltd. and B Ltd. Amalgamated to form C ltd.	A ltd. Takes over the business of another existing company B ltd.	B ltd. Is formed to take over the business of an existing company A ltd.

Types of Amalgamation



Amalgamation and Accounting Standard 14

According to AS 14 on Accounting for Amalgamations; the following conditions must be satisfied for an amalgamation in the **nature of merger** :

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

(vi) All reserves and surplus of the transferor company shall be preserved by the transferee company.

If any one of the condition is not satisfied in a process of amalgamation, it cannot be treated as amalgamation in the nature of merger.

In the Nature of Purchase

Amalgamation In the nature of purchase is an amalgamation which does not satisfy any and one more condition which have been discussed in amalgamation in the nature of merger.

Method of Accounting for Amalgamation

- The Pooling of interest method or the nature of merger
- The purchase method

The Pooling of Interest Method or The Nature of Merger

This method is followed in case of an amalgamation in the nature of merger. Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts and in the same form as at the date of the amalgamation.

The balance of the Profit and Loss Account of the transferor company is aggregated with the balance of the Profit and Loss Account of the transferee company or transferred to the General Reserve, if any.

The difference between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets on the one hand and the amount of share capital of the transferor company on the other hand is adjusted in reserves.

If, at the tune of the amalgamation, the transferor and transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation.

The effects on the financial statements of any changes in accounting policies are reported in accordance with Accounting Standard (AS) 5 (Revised)—'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

The Purchase Method

This method is followed in case of an amalgamation in the nature of purchase. Under this method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities of the transferor company at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation.

The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company. Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company.

For example, the transferee company may have a specialized use for an asset. Also, the transferee company may intend to effect changes in the activities of the transferor company which may necessitate the creation of specific provisions for the expected cost, for example, planned employee termination and plant relocation costs.

The reserves (whether capital or revenue or arising on revaluation) of the transferor company, other than the statutory reserves, are not included in the financial statements of the transferee company.

Calculation of Purchase consideration in case of Amalgamation in the Nature of Purchase

In this case, purchase consideration may be calculated by the following methods :

1. Lumpsum Method (Adhoc Method)

It is simple to ascertain purchase consideration by purchase method. In fact no calculation is to be made for calculation of purchase consideration, since it is given in the problem as a single amount.

For example, it may be stated that R Ltd. takes the business of Q Ltd. for ₹ 80,00,000.

So, in this case purchase consideration will be₹ 80,00,000.

2. Net Assets Method

In this method, total value of the assets of transferor company purchased by the transferee company should be found. Total value of assets should be found by adding the values mutually agreed upon, not the book values. Assets which have not been purchased by the transferee company should not be included in the total. Intangible assets should be included at the agreed price. This total of the values of assets purchased is called the 'Gross value of Assets'.

Total value of liabilities taken over by the transferee company should also be found. If the agreed values of liabilities are not known, these should be taken at their book values. If agreed value is known then it should be taken at that value only. Total value of liabilities should be subtracted from the gross value of assets. Remaining amount is called the 'Net value of assets' and this will be the amount of purchase consideration.

When a certain amount is paid by the transferee company to the transferer company as purchase consideration, then the 'Net value of assets' should be compared with the amount of purchase consideration. Excess of the amount of purchase consideration paid to the transferee company over the net value of assets should be treated as 'Goodwill' created as a result of amalgamation by the transferee company, and this excess should be debited to the 'Goodwill account'. If the said purchase consideration is less than the net value of assets purchased, the difference should be treated as capital reserve.

Statutory Reserves of the Transferer Company : Statutory reserves of the transferer company should be entered in the financial statements of the transferee company. For doing so, a new account 'Amalgamation Adjustment Account' should be debited and 'Statutory Reserves' account should be credited.

Balance of this adjustment account should be shown in the Balance Sheet under the head 'Miscellaneous Expenditure' or any other such head. When the period of holding the aforesaid statutory reserves as such is over, reverse entry of the above journal entry should be passed.

Reserves of the transferer company other than the statutory reserves should not be included in the financial statements of the transferee company.

Net Payment Method

Under this method all payments made in the form of shares, debentures, other securities and cash to the shareholders of the transferer company are aggregated to obtain purchase consideration. As per AS 14, purchase consideration comprises only payments made to shareholders. Therefore purchase consideration should not include the payments made to debenture holders and creditors. Shares issued by the transferee company must be valued at market price for the purpose of purchase method.

Illustration : Ram Ltd. agreed to acquire the assets excluding cash as on 31st March, 2016 of Shyam Company Ltd. The Balance Sheet of Shyam Ltd. as on that date was :

Balance Sheet of Shyam Ltd. as at 31st March, 2016

			Figures ₹
I. EQUITY AND LIABILITIES			
(1) Shareholders Funds			
(a)	Share Capital		
	Authorised		……..
	Issued and Subscribed		
	Equity Share of ₹ 10 each		6,00,000
(b)	Reserve and Surplus :		
	General Reserve		1,60,000
	Statement of Profit and Loss		1,20,000
			₹
(2) Share Application money pending allotment			–
(3) Non-Current Liabilities			1,00,000
	6% Debentures		
(4) Current Liabilities :			20,000
	Trade payables(Creditors)	Total	10,00,000
II. ASSETS			
(1) Non-Current Assets			
(a)	Fixed Assets		
	(i) Tangible Assets :		
	Land and Buildings		2,40,000
	Plant and Machinery		4,00,000
	(ii) Intangible Assets :		
	Goodwill		1,20,000
(b)	Non-Current Investments		–
(2) Current Assets			
	Cash and Cash Equivalent (Cash)		20,000
	Stock		1,60,000
	Trade Receivable : (Debtors)		60,000
		Total	10,00,000

The consideration was as follows :

1. A cash payment of ₹ 3 was made for every share of Shyam Ltd.
2. Ram Ltd. will issue one share of ₹ 12.50 each fully paid in exchange of one share in Shyam Ltd.
3. The issue of 1,100 debentures of ₹ 100 each in Ram Ltd. to enable Shyam Ltd. to discharge its debentures at a premium of 10%.
4. The expenses of liquidation of Shyam Ltd. amounting to ₹ 8,000 was to be met by themselves.

Calculate Purchase Consideration.

Solution : Calculation of Purchase Consideration :

	₹
Cash 60,000 × ₹ 3	1,80,000
Shares 60,000 × ₹ 12.50	7,50,000
Purchase Consideration	9,30,000

Note :

(a) The liquidation expenses of Shyam Ltd. are to be met by themselves. Hence, these expenses should not be included in Purchase Consideration.

(b) Payment to debenture holders on acquiring a company is not the part of purchase consideration as per AS–14.

Illustration : X Ltd. and Y Ltd. agreed to amalgamate (in the nature of purchase) their businesses on 1st April, 2016. A new company Z Ltd. was formed to takeover the assets and liabilities of the two companies. The purchase consideration was to be satisfied in shares of Z Ltd.

The Balance Sheets of X Ltd. and Y Ltd. as at 31st March, 2016 were as follows :

Balance Sheets as at 31st March, 2016

I. EQUITY AND LIABILITIES	X Ltd. Figures ₹	X Ltd. Figures ₹
(1) Shareholders Funds		
(a) Share Capital		
Authorised	–	–
Issued and Subscribed		
Equity Share of ₹ 10 each	10,00,000	14,00,000
(b) Reserve and Surplus :		
Statutory Reserve	12,00,000	5,00,000
General Reserve	500,000	5,00,000
(2) Share Application money pending allotment	–	–
(3) Non-Current Liabilities	–	–
(4) Current Liabilities :		
Trade Payables : (Creditors)	4,00,000	9,00,000
Bank Overdraft	–	9,00,000
Total	31,00,000	42,00,000

II. ASSETS			
(1) Non-Current Assets			
(a) Fixed Assets			
(i) Tangible Assets :			
Sundry Fixed Assets		12,00,000	18,00,000
(ii) Intangible Assets :		–	–
(b) Non-Current Investments		–	–
(2) Current Assets			
Cash and Cash Equivalent :		5,00,000	–
Stock		6,00,000	11,00,000
Trade Receivable : (Debtors)		8,00,000	13,00,000
Total		31,00,000	42,00,000

Z Ltd. valued fixed assets of X Ltd. at ₹ 15,00,000 and that of Y Ltd. at ₹ 20,00,000 other assets and liabilities were taken over at book values. Goodwill of X Ltd. was to be calculated on a Weighted Average of net profits for the past three years. The weights for this purpose may be taken as 1, 2, 3, respectively. The net profits were in the year 2013-14 ₹ 2,00,000; in the year 2014-15 ₹ 8,00,000; in the year 2015-16 ₹ 12,00,000.

In order to raise working capital, Z Ltd. issued 1,20,000 equity shares of ₹ 10 each at a price of ₹ 17.50 per share.

You are required to (a) calculate the purchase consideration payable to X Ltd. and Y Ltd., (b) prepare the balance sheet of Z Ltd.

Solution. **Valuation of Goodwill of X Ltd.**

Year	Net Profit	Weight	Product
	₹		₹
2013-2014	2,00,000	1	2,00,000
2014-2015	8,00,000	2	16,00,000
2015-2016	12,00,000	3	36,00,000
		6	54,00,000

$$\text{Value of Goodwill} = \frac{54,00,000}{6} = ₹\ 9,00,000$$

Calculation of Purchase Consideration

	X Ltd.		Y Ltd.	
	₹	₹	₹	₹
Assets Taken Over				
Goodwill	9,00,000			
Fixed Assets	15,00,000		20,00,000	
Stock	6,00,000		11,00,000	
Debtors	8,00,000		13,00,000	
Cash at Bank	5,00,000	43,00,000	–	44,00,000
Less: Creditors	4,00,000		9,00,000	
Bank Overdraft	–	4,00,000	9,00,000	18,00,000
Net Assets or Purchase Consideration		39,00,000		26,00,000

Balance Sheet of Z Ltd. as at 1st April, 2016

(soon after Amalgamation and Issue of Shares)

			Figures ₹
I. EQUITY AND LIABILITIES			
(1) Shareholders Funds			
(a)	Share Capital		
	Authorised		....
	Issued and Subscribed		₹
	6,50,000 Equity Shares of ₹ 10 each issued for consideration other than cash		65,00,000
	1,20,000 Equity Shares of ₹ 10 each issued for cash		12,00,000
(b)	Reserve and Surplus :		
	Statutory Reserve		17,00,000
	Securities Premium		9,00,000
(2) Share Application money pending allotment			–
(3) Non-Current Liabilities			–
(4) Current Liabilities :			
	Trade Payables : (Creditors)		13,00,000
	Total		1,16,00,000
II. ASSETS			
(1) Non-Current Assets			
(a)	Fixed Assets		
	(i) Tangible Assets :		
	Sundry Fixed Assets		35,00,000
	(ii) Intangible Assets :		9,00,000
(b)	Other Non-Current Assets		
	Amalgamation Adjustment a/c		17,00,000
(2) Current Assets			
	Cash and Cash Equivalent : Cash at Bank		17,00,000
	Stock		17,00,000
	Trade Receivable : (Debtors)		21,00,000
	Total		11,600,000

Note : Cash at bank, in the above balance sheet has been shown after deducting bank overdraft.

Calculation of Bank Balance

	₹
Opening Balance	5,00,000
**Add* : Issue of Shares (₹ 12,00,000 + Premium ₹ 9,00,000)	21,00,000
	26,00,000
Less : Bank Overdraft	9,00,000
Closing Balance	17,00,000

Intrinsic Value of Shares Method

Under this method purchase consideration is discharged by transferee company on the basis of intrinsic value of shares of transferee and transferor companies. Intrinsic value of shares is calculated in the following manner :

Total of all assets on revalued price (if any) Subtracted by all outside liabilities at revalued price including preferential shares.

Illustration : A Ltd. and B Ltd. are amalgamated as on 1st April, 2016 and a new company C Ltd. is to be formed. The balance sheets of A Ltd. and B Ltd. as on 31st March, 2016 were as follows:

Balance Sheets as at 31st March, 2016

		A Ltd. Figures ₹	B Ltd. Figures ₹
I. EQUITY AND LIABILITIES			
(1) Shareholders Funds			
(a)	Share Capital		
	Authorised	–	–
	Issued and Subscribed		
	Equity Share of ₹ 10 each	12,00,000	18,00,000
	Preference Shares of ₹ 10 each	4,00,000	5,00,000
(b)	Reserve and Surplus :	–	–
(2) Share Application money pending allotment		–	–
(3) Non-Current Liabilities			
	6% Debentures	1,00,000	3,00,000
(4) Current Liabilities :			
	Trade Payables : (Creditors)	3,00,000	9,00,000
	Bank Overdraft	3,00,000	4,00,000
	Total	23,00,000	39,00,000
II. ASSETS			
(1) Non-Current Assets			
(a)	Fixed Assets		
	(i) Tangible Assets :		
	Sundry Fixed Assets	13,40,000	28,20,000
	(ii) Intangible Assets :		
	Goodwill	80,000	1,20,000
(b)	Non-Current Investments	–	–
(2) Current Assets			
	Sundry Current Assets	8,80,000	9,60,000
	Total	23,00,000	39,00,000

Sundry Fixed Assets of A Ltd. and B Ltd. have been revalued at ₹ 12,00,000 and 24,00,000 respectively. Calculate intrinsic value of shares.

Solution. Calculation of Intrinsic Value of Shares

		A Ltd. ₹	B Ltd. ₹
Goodwill		80,000	1,20,000
Sundry Fixed Assets		12,00,000	24,00,000
Current Assets		8,80,000	9,60,000
	(A)	21,60,000	34,80,000
Less :			
Creditors		3,00,000	9,00,000
Bank Overdraft		3,00,000	4,00,000
6% Debentures		1,00,000	3,00,000
		₹	₹
Preference Shares		4,00,000	5,00,000
	(B)	11,00,000	21,00,000
Net Assets for Equity Shareholders (A – B) = (i)		10,60,000	13,80,000
No. of Shares (ii)		1,20,000	1,80,000

Intrinsic Value of Shares (A Ltd.) (i) ÷ (ii) ₹ $\left(\frac{10,60,000}{1,20,000}\right)$ = ₹ 8.833

Intrinsic Value of Shares (B Ltd.) ₹ $\left(\frac{13,80,000}{1,80,000}\right)$ = ₹ 7.667

Distinction Between Pooling of Interest (Merger) Method and Purchase Method

1. Pooling Interest method is used when amalgamation is in the nature of merger while purchase method is used where amalgamation is in the nature of purchase.
2. In Pooling Interest Method all the assets and liabilities, reserves and profit & loss accounts of transferee company are incorporated in the accounts of transferee company but in purchase method only assets and liabilities are incorporated in the books of transferee company. In case of pooling interest method there is complete amalgamation of accounts while in case of purchase method there is only partial amalgamation of accounts of both the companies.
3. In Pooling Interests method the difference of net assets received by transferee company and the purchase consideration is not shown as goodwill or as capital reserve while in purchase method, the difference of net assets received by transferee company and the purchase consideration is shown as goodwill or as capital reserve.
4. In pooling interest method statutory reserves of transferee company are incorporated in the total reserves of transferee company hence, no amalgamation adjustment account is required to be opened. But in purchase method while incorporating the statutory reserves the transferee company has to open amalgamation adjustment account. This account is debited with the amount of statutory reserves being incorporated.
5. In case of amalgamation in the nature of merger, revaluation of Assets and Liabilities cannot be carried out, while in case of purchase, purchasing company may make a revaluation of assets and liabilities.

6. In case of merger, the merged company has to carry on the business of merging company. While in case of purchase it is not necessary to continue the business.
7. In case of merger purchase consideration cannot be paid in cash but in purchase method it may be paid in cash.
8. For being amalgamation in the nature of merger, 90% of Equity Shareholders of transferer company should become the shareholders of transferee company, but in case of purchase it is not required.

Accounting Entries in the books of Transferer or Vendor Company in case of Amalgamation in the Nature of Merger

Accounting Standard-14 (As-14) is related to principles and procedure for accounting in the books of transferee (purchaser) company. In this context there is no any principle or procedure described for recording transactions in the books of transferer (Vendor) Company. The Accounting procedure in the books of accounts of the transferer company will be done according to general principles of liquidation or dissolution. So, in the case of amalgamation of both the nature of merger and purchase, balance of reserves profit and loss and fictitious assets as shown in the books of transferer company will be transferred to equity shareholders account, not to realisation account. In this case journal entries are made as under :

1. For closing of all assets (Tangible, Non-tangible and Fictitious Assets) Accounts.

Realisation a/c	Dr.
To particulars Assets (individually)	(at book figures)

2. For closing of all liabilities items (Excluding Equity Share Capital and Preference Share Capital).

(Particular) Liabilities a/c	Dr. (at book figure)
(Particular) Provision a/c	Dr.
To Realisation a/c	

3. When purchase Consideration is due from purchaser company.

Purchasing Company a/c	Dr. (With the amount of purchase
To Realisation a/c	consideration)

4. When purchase consideration is received from the purchaser company.

Bank a/c	Dr.
Preference Shares in Purchasing Co. a/c	Dr.
Equity Shares in Purchasing Co. a/c	Dr.
To Purchasing Co.	

4.(a) The entries in relation to realisation expenses are given in this topic under the head Journal entries in case of amalgamation in the nature of purchase.

5. On transfer of Preference Shares Capital to the Preference Shareholders Account.

Preference Share Capital a/c	Dr.
To Preference Shareholders a/c	

6. Preference Shares (received from purchasing co.) given to Preference Shareholders.

Preference Shareholders a/c	Dr.
To Preference Shares in Purchasing Co. a/c	
To Equity Share in Purchasing Co. a/c.	

To Bank a/c

In vendor company's books if payment is made to Preference Shareholders under or over share capital, then difference will be transferred to Realisation Account in Credit side or Debit side as the case may be.

7. On transfer of Equity Shareholders Account to Equity Share Capital Account.

Equity Share Capital a/c Dr.
To Equity Shareholders a/c

8. On transfer of Reserved profits to equity shareholders Accounts:

Reserves a/c Dr.
Statement of Profit & Loss Dr.
To Equity Shareholders a/c

9. On transfer of Fictitious assets to equity shareholders account.

Equity Shareholder a/c Dr.
To Fictitious Assets a/c

10. Closing of Realisation Account (if there is Credit balance).

Realisation a/c Dr.
To Equity Shareholders a/c
To Statement of Profit & Loss

11. Closing of Realisation Account (If there is debit balance).

Equity Shareholders a/c Dr.
To Realisation a/c

12. Consider Received from purchasing company given to Equity Shareholders.

Equity Shareholders a/c Dr.
To Equity Shares of Purchasing Co. Ltd. a/c
To Bank a/c

Accounting Entries in the Books of Purchasing or Transferee Company

1. On purchasing of sundry assets and liabilities of vendor co.

(Particular) Assets a/c Dr. (at book figure)
To (Particular) Liabilities a/c (at book figure)
To (Particular) Reserve a/c (at book figure or adjusted amount)
To Liquidator of Vender Co. a/c (with the amount of purchase consideration)

2. On payment of purchase consideration to liquidator of vendor co.

Liquidator of Vendor Co. a/c Dr.
To Equity Share Capital a/c
To Securities Premium a/c
To Bank a/c (payment made in respect of fraction of share only)

3. When realisation expenses are paid by purchaser co.

Goodwill/Capital Reserve a/c Dr.
To Bank a/c

In Merger Method of amalgamation in the books of purchasing company no capital reserve and goodwill arises. If there is any difference in share capital of transferer co. and purchase consideration, then the difference is adjusted against General Reserve or Statement of Profit & Loss.

Illustration : Kamal Ltd. and Nirmal Ltd. are engaged in the soap making activities. To get the benefits of large scale production economies, Kamal Ltd. decided the absorption of Nirmal Ltd. with effect from 1st April, 2016.

Balance Sheets as at 31st March, 2016

	Kamal Ltd. Figures ₹	Nirmal Ltd. Figures ₹
I. EQUITY AND LIABILITIES		
(1) Shareholders Funds		
(a) Share Capital : *Authorised*	–	–
Issued and Subscribed		
(b) Reserve and Surplus :	₹	₹
Securities Premium	6,00,000	30,000
Export Incentive Reserve	3,00,000	3,000
General Reserve	13,50,000	24,000
Statement of Profit and Loss	4,50,000	3,000
(2) Share Application money pending allotment	–	–
(3) Non-Current Liabilities		
Secured Loan	6,00,000	–
(4) Current Liabilities : Sundry Current Liabilities	9,00,000	6,00,000
Total	60,00,000	15,60,000
II. ASSETS		
(1) Non-Current Assets		
(a) Fixed Assets		
(i) Tangible Assets :		
Land and Buildings	24,00,000	3,00,000
Plant and Machinery	15,00,000	4,50,000
(b) Non-Current Investments	–	–
(2) Current Assets		
Cash and Cash Equivalent :		
Cash at Bank	3,00,000	30,000
Stock	6,00,000	7,20,000
Trade Receivable : (Debtors)	12,00,000	60,000
Total	60,00,000	15,60,000

The scheme of absorption provides :

1. All shareholders of the transferer company Nirmal Ltd. will get one equity share of the transferee company Kamal Ltd. at par i.e. ₹ 10 for one equity share.
2. All the assets and liabilities of the transferor company will be acquired by the transferee company from the effective date at their book values.

Pass the journal entries at the time of amalgamation in the Books of Kamal Ltd. and Nirmal Ltd. Also give the Balance Sheet after amalgamation.

Solution. Calculation of Purchase Consideration :

Payment to shareholders of Nirmal Ltd. = 90,000 Shares of ₹ 10 each = ₹ 9,00,000

Journal of Nirmal Ltd. (Transferor Co.)

2016			₹	₹
April, 1	Realisation a/c	Dr.	15,60,000	
	To Land & Building			3,00,000
	To Plant & Machinery a/c			4,50,000
	To Debtors a/c			60,000
	To Stock a/c			7,20,000
	To Bank a/c			30,000
	(Sundry Assets Transferred.)			
April, 1	Current Liabilities a/c	Dr.	600,000	
	To Realisation a/c			6,00,000
	(Sundry liabilities Transferred.)			
April, 1	Securities Premium a/c	Dr.	30,000	
	Export Incentive Reserve a/c	Dr.	3,000	
	General Reserve a/c	Dr.	24,000	
	Statement of Profit & Loss	Dr.	3,000	
	To Equity Shareholders a/c			60,000
	(Balance Transferred.)			
April, 1	Equity Share Capital a/c	Dr.	9,00,000	
	To Equity Shareholders a/c			9,00,000
	(Balance Transferred.)			
April, 1	Kamal Ltd.	Dr.	9,00,000	
	To Realisation a/c			9,00,000
	(Purchase Consideration due.)			
April, 1	Equity Shareholders a/c	Dr.	60,000	
	To Realisation a/c			60,000
	(Loss on Realisation transferred to Equity Shareholders.)			
April, 1	Equity Share in Kamal Ltd. a/c	Dr.	9,00,000	
	To Kamal Ltd.			9,00,000
	(Being Equity Shares received from Kamal Ltd. Against purchase consideration.)			
April, 1	Equity Shareholders a/c	Dr.	9,00,000	
	To Equity Shares in Kamal Ltd. a/c			9,00,000
	(Shares received from Kamal Ltd. given to Equity Shareholders.)			

Journal of Kamal Ltd. (Purchasing Co.)

					₹	₹
2016					₹	₹
April, 1	Land and Building a/c		Dr.		3,00,000	
	Plant & Machinery a/c		Dr.		4,50,000	
	Debtors a/c		Dr.		60,000	
	Stock a/c		Dr.		7,20,000	
	Bank a/c		Dr.		30,000	
		To Securities Premium				30,000
		To Export Incentive Reserve a/c				3,000
		To General Reserve a/c				24,000
		To Statement of Profit & Loss				3,000
		To Current Liabilities a/c				6,00,000
		To Liquidator of Nirmal Ltd.				9,00,000
	(Being acquisition of Assets and Liabilities of Nirmal Ltd. and purchase consideration due.)					
April, 1	Liquidator of Nirmal Ltd. a/c		Dr.		9,00,000	
		To Equity Share Capital a/c				9,00,000
	(Issue of 90,000 equity shares of ₹ 10 each fully paid up for the purchase consideration.)					

Balance Sheet of Kamal Ltd. as at 1st April, 2016

		Figures ₹
I. EQUITY AND LIABILITIES		
(1) Shareholders Funds		
(a)	Share Capital : *Authorised*	–
	Issued and Subscribed	
	2,70,000 Equity Shares of ₹ 10 each fully paid up	27,00,000
	(90,000 Equity Shares of ₹ 10 each fully paid up issued other than cash)	
(b)	Reserve and Surplus :	
	Securities Premium	6,30,000
	Export Incentive Reserve	3,03,000
	General Reserve	13,74,000
	Statement of Profit and Loss	4,53,000
(2) Share Application money pending allotment		–
(3) Non-Current Liabilities		
	Secured Loan	6,00,000
(4) Current Liabilities :		
	Sundry Current Liabilities	15,00,000
Total		75,60,000

II. ASSETS		
(1) Non-Current Assets		
(a)	Fixed Assets	
	(i) Tangible Assets :	
	Land and Buildings	27,00,000
	Plant and Machinery	19,50,000
(2) Current Assets		
Cash and Cash Equivalent :		
	(Cash at Bank)	3,30,000
Stock		13,20,000
Trade Receivable : (Debtors)		12,60,000
Total		75,60,000

Accounting Entries in case of Amalgamation in the Nature of Purchase

Accounting in the Books of Vendor Company :

If amalgamation is of the nature of purchase, accounts in the books of vendor company are prepared in the same manner as in case of winding up. In each case Realisation Account is prepared and journal entries are as follows :

1. **On Transfer of assets purchased by Purchaser company to Realisation Account.**

   Realisation a/c Dr. (Book Value)

   To (Particular) Assets a/c

2. **On Transfer of liabilities taken over by purchaser company to Realisation Account.**

   Liabilities a/c Dr. (Book Value)

   To Realisation a/c

3. **On transfer of Statutory Reserve to Realisation Account.**

   Statutory Reserves a/c Dr.

   To Realisation a/c

4. **When purchase consideration is due from Purchaser Co.**

   Purchasing Co. a/c Dr.

   To Realisation a/c

5. **When purchase consideration is received from Purchaser Co.**

   Bank a/c Dr.

   Preference Shares in Purchasing Co. a/c Dr.

   Equity Shares in Purchasing Co. a/c Dr

   To Purchasing Co. a/c

6. **On Transfer of Preference Share Capital to the Preference Shareholders a/c.**

   Preference Share Capital a/c Dr.

   To Preference Shareholders a/c

7. **When arrear of dividend on preference shares is due for payment.**

   Realisation a/c Dr.

   To Preference Share Dividend a/c

   Preference Share Dividend a/c Dr.

   To Preference Shareholders a/c

Note : One entry can be made instead of above two entries.

Realisation a/c Dr.

To Preference Shareholders a/c

However, it is better to make two entries instead of one combined entry. It would show appropriate explanation.

8. On payment made to Preference Shareholders.

Preference Shareholders a/c Dr.

To Cash/Bank a/c

To Equity Shares in Purchasing Co. a/c

To Preference Share in Purchasing Co. a/c

9. If the purchasing company has not taken Debentures of the vendor company and vendor company itself is paying to debentureholders, then the balance of Debentures account and interest due thereon is transferred to Debentureholders a/c.

Debentures a/c Dr.

Accrued Interest on Debentures a/c Dr.

To Debenturholders a/c

10. On payment made to Debentureholders.

Debentureholders a/c Dr.

To Bank a/c

To Debentures of Purchasing Co. a/c

Note : If there is any profit or loss on making payment of outside liability then such profit or loss should be transferred to Realisation Account.

11. On transfer of Equity Share Capital, all Revenue and Capital Reserves to Equity Shareholders account.

Equity Share Capital a/c Dr.

General Reserve a/c Dr.

Statement of Profit & Loss Dr.

Capital Reserve a/c Dr.

Particular Reserve a/c Dr.

To Equity Shareholders a/c

12. On transfer of all the fictitious assets and accumulated losses to Equity Shareholders Account.

Equity Shareholders a/c Dr.

To Statement of Profit & Loss

To Preliminary Expenses a/c

To (Particular) Loss a/c

13. On Realisation from assets not purchased by Purchaser Company.

Cash/Bank a/c Dr. (by actual amount received)

Realisation a/c Dr. (by the amount of loss)

To (Particular) Assets a/c (by book value)

Note : Realisation Account is credited in the case of profit.

14. On payment of liability which are not taken by Purchaser Company.

Creditors (or Particular Liability) a/c Dr. (by book value)

To Cash/Bank a/c (by cash amount)

To Preference Shares in Purchasing Co.a/c (by value of preference share)

To Equity Shares in Purchasing Co. a/c (by paid up value of equity share)

15. Entry for Realisation Expenses : About the Realisation expenses of the old company, one of the following three situations is possible :

(a) If realisation expenses are paid by purchasing company then no entry will be passed in the books of vendor company.

(b) When the old company (vendor company) pays the realisation expenses from its own amount in cash : In this case the following journal entry will be made :

Realisation a/c Dr. (by the amount of realisation expenses)

To Bank a/c

(c) When realisation expenses are realised from the new company but the amount is not included in purchase consideration : In this case, when the amount for realisation expenses is received from the new company, following journal entry is made :

Back a/c Dr. (by the amount received)

To Realisation a/c

When realisation expenses are paid by the old company following journal entry will be made :

Realisation a/c Dr.

To Bank a/c

In this case the amount of realisation expenses is not included in purchase consideration, so it is not involved in the journal entry for the purchase consideration payable. Therefore, the above journal entry is made when the amount for realisation expenses is received from the new company.

16. On transfer of loss from Realisation Account to Equity Shareholders Account.

Equity Shareholders a/c Dr.

To Realisation a/c

17. On transfer of profit from Realisation Account to Equity Shareholders Account.

Realisation a/c Dr.

To Equity Shareholders a/c

18. On payment made to Equity Shareholders.

Equity Shareholders a/c Dr.

To Cash/Bank a/c

To Equity Shares in purchasing Co. a/c

To Preference Shares in Purchasing Co. a/c

Entries in the books of the purchaser company (New Company) :

The new company purchases the business of the old company, i.e., its assets and liabilities, and pays the purchase consideration. In general it can be said that in the books of the new company entries will be made about the 'Purchase of Business' to record the above transactions. First of all, following Journal entry will be made when the assets and liabilities are purchased and purchase consideration is to be paid.

Assets a/c Dr. (give names)

Goodwill a/c	Dr.	
To Liabilities a/c		(give names)
To Liquidators of .... Ltd.		(by the amount of purchase consideration)
To Capital Reserve a/c		

From the above journal entry it is clear that purchase consideration has become due and it is payable to the liquidator of the old company and it is to be paid.

If the value of total assets taken by purchaser company is less than the value of total liabilities and purchase consideration then the difference value is treated as goodwill, and if the total value of liabilities and purchase consideration is less than the total value of all assets then the difference value is to be treated as capital reserve.

When Purchasing Company takes the benefit of Statutory Reserve then entry shall be made as follows :

Amalgamation Adjustment a/c	Dr.
To Statutory Reserve a/c	

Journal entries of these transactions are made in the books of the new company according to general rules. Following Journal entry is made on payment of purchase consideration to the liquidator of old company :

Liquidator of Vendor Co. a/c	Dr.	
Discount a/c	Dr.	(If shares are issued at discount)
To Preference Share Capital a/c		(by paid up value)
To Equity Share Capital a/c		(by paid up value)
To Securities Premium a/c		(by premium amount)
To Cash a/c		(by Cash amount)

However, it should be noted that if the payment of purchase consideration involves issue of partly paid up equity or preference shares and cash payment, and the company does not have enough money to make the payment in cash, then first the Journal entry will be made for the allotment of shares to the liquidator of old company, after that when call money is due and is received, its journal entry will be made, and then journal entry of cash payment to the liquidator of old company will be made.

Payment of Realisation expenses of the old company by the new company (purchaser co.) and its accounting entries :

If the realisation expenses of vendor company are paid by purchaser company, this is in addition to purchase consideration. In this situation the following Journal entry will be made for such payment:

Goodwill/Capital Reserve a/c	Dr.
To Cash a/c	

In the above transaction the new company gives away cash amount, so cash a/c is credited. For the new company the above payment is related with the purchase of the business of old company, Therefore it is appropriate to debit the same to the Goodwill account. In coming years when the company earns profit, the balance in goodwill account will be written off in 5 years.

Note : No entry shall be passed, if realisation expenses is part of purchase consideration.

Accounting for Corporate Restructuring : Internal Reconstruction

The process of 'reconstruction' is adopted in order to reorganize a company. In this sense, the term 'reconstruction' has a wide scope, because reconstruction or reorganization of a company may take any one of the following two shapes :

1. Internal Reconstruction; or
2. External Reconstruction.

Internal Reconstruction

It is also named as semi-reorganization, and the external reconstruction as complete reorganization. Because, under internal reconstruction the existence of the company remains as it is, only its capital structure, is changed whereas, under external reconstruction the existing company goes into liquidation and a new company is formed with almost a similar name, and this new company purchases the whole business of the existing company.

Desirable Conditions for Internal Reconstruction

In this sense, internal reconstruction is necessary and desirable in the following situations :

1. When the company is over-capitalised; i.e. assets shown in the balance sheet do not represent completely the capital of the company, and the assets have been shown in the balance sheet at values higher than their actual value and it is necessary to bring the same at their real values;
2. When the company had suffered heavy losses in the past years and it is necessary to write off these losses so that in future the company may safeguard the interests of its shareholders and debenture holders;
3. When the market value of the share of the company is not attractive for the potential investors.
4. When capital gearing of the company is not proper and it is necessary to bring a change in it.

No Winding-up in Internal Reconstruction

It is the speciality of internal reconstruction that under this plan the company is not wound-up but the same company starts functioning afresh with new blood, new vigour and enthusiasm. **Kohler** has named internal reconstruction as 'Quasi-Reorganization'. A recapitalization, a principal feature of which has been the absorption of a deficit; specifically the procedure whereby a corporation, without the creation of a new corporate entity, eliminates an operating deficit or a deficit resulting from the recognition of other losses, or both, and establishes a new retained earnings account for the accumulation of net income subsequent to the effective date of such action.

It is clear from the above description that the main characteristic of internal reconstruction is recapitalization. Recapitalization means :

1. Alteration in share capital, or
2. Reduction in the share capital.

1. Alteration in share capital

(i) Increase in share capital by issue of new share : If the company has fully issued its authorised capital, and now it requires more capital, then it can alter, the conditions in its memorandum of association and can increase the authorised capital. If necessary, permission of SEBI (Securities and Exchange Board of India) will be obtained for the same.

The only condition in respect of the issue of new shares is that the shares will be first offered to the existing equity shareholders of the company. If these shareholders do not purchase the new shares then only these new shares can be offered to other persons. This right of the existing shareholders is called preferential purchase right or pre-emption. This right is given to them under section 62 of the Companies Act, 2013.

2. Reduction in Share Capital

1. Section 66 (1) : Subject to confirmation by the court (Tribunal) on an application by the company, a company limited by shares or limited by guarantee and having a share capital may be a special resolutions, reduce the share capital in any manner and in particular, may–

(a) Extinguish or reduce the liability on any of its share capital not paid; or

(b) Either with or without extinguishing or reducing liability on any of its share.

(i) Cancel any paid up share capital which is lost or is unrepresented by available assets, or

(ii) Pay off any paid up share capital which is in excess of the wants of the company, after its memorandum by reducing the amount of its share capital and of its share accordingly.

Provided that no such reduction shall be made if the company is in areas in the repayment of any deposits accepted by it, either before or after the commencement of this Companies Act, 2013 or interest payable thereon.

2. Section 66 (2) : The Count (Tribunal) Shall give notice of every application made to it under subsection (i) to the Central Government Registrar and to the SEBI, in case of closed companies and the creditors of the company and shall take into consideration the representation, if any made to it by the Government, Registrar, SEBI and creditors within a period of 3 months from the date of receipt of the notice.

Provided that where no representation has been received from these four parties within the said period, it shall be presumed that they have no objection to the reduction.

3. Section 66 (3) : The Court (Tribunal) may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained make an order confirming the reduction of share capital on such terms and conditions as it deems fit.

Provided the no application for reduction of share capital shall be sanctioned by the court (Tribunal) unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133 or any other provision of this Companies Act, 2013 and a certificate to the effect by the company's auditor has been filed with the court (Tribunal).

4. Section 66 (4) : The order of confirmation of the reduction of share capital by the court (Tribunal) under sub-section (3) shall be published by the company in such manner as the court (Tribunal) may direct.

5 Section 66 (5) : The company shall deliver a certified copy of the order of the court (Tribunal) under sub-section (3) with details specified in this sub-section to the Registrar within 30 days of the receipt of copy of the order, who shall register the same and issue a certificate to that effect.

6. Section 66 (6) : Nothing in section shall apply to buy-back of its own securities by a company under section 68 of the Companies Act, 2013.

Process of Internal Reconstruction

The process of internal reconstruction may assume the following forms :

1. Reorganising the capital structure by writing off the lost capital.
2. Reorganising without reduction of share capital.
3. Scheme of arrangement with shareholders, debentureholders and creditors.

Accounting under the Capital Reduction Scheme :

1. (a) When the denomination (face value of preference shares and equity shares is reduced):

(Old Denomination) Share Capital a/c	Dr.	(with the amount credited in old Capital a/c)
To (New Denomination) Share Capital a/c		(with the amount of new Capital account)
To Capital Reduction a/c		(with the amount reduced)

Note : In lack of any information, the new share issued will be fully paid up.

(b) If there is no any change in face value of the shares then the amount by which the capital has been reduced, the entry will be as follows :

Share Capital a/c Dr

To Capital Reduction a/c

The amount by which capital has been reduced, can be recovered from the shareholders, whenever required in future.

(c) If the face value of shares changes and the new shares issued are partly paid up e.g. company issues a share of new face value of ₹ 5 instead of old face value ₹ 10 having paid up value of ₹ 3 instead of old share having face value ₹ 10. The entry will be as follows :

(Old Denomination) Share Capital a/c	Dr.	₹ 10
To (New) Share Capital ₹ 5 a/c		₹ 3
To Capital Reduction a/c		₹ 7

Company can demand the balance of ₹ 2 from shareholders at any time in future.

2. When the denomination of preference shares or equity shares is not changed, but their paid-up amount is reduced –

Share Capital a/c Dr. (By the amount reduced)

To Capital Reduction a/c

3. Sometimes creditors and debentureholders also agree for sacrifice. In such case, their claims are also reduced. Journal entry for such reduced amount will be as follows–

Creditors a/c Dr.

Debentures a/c Dr.

To Capital Reduction a/c

4. If there is credit balance in General Reserve Account or in any other reserve account in the books of the company, then the credit balance of these accounts should be transferred to the 'Capital Reduction A/c' under the 'Capital reduction scheme'. Journal entry will be as follows–

General Reserve/Other Reserve a/c Dr.

To Capital Reduction a/c

5. If on revaluation, the value of any asset is increased, the Journal entry for the increased amount will be made as follows–

Asset a/c Dr.

To Capital Reduction a/c

Similarly if there is any profit to the company, the amount of profit will be credited to the 'Capital Reduction Account'.

6. If the amount credited to 'Capital Reduction Account' is used for reducing the trading losses specific losses, amount of goodwill, fictitious assets and tangible and intangible assets, then Journal entry will be as follows –

Capital Reduction a/c Dr.

To Statement of Profit and Loss

To Discount on Issue of Debentures a/c

To Preliminary Expenses a/c

To Goodwill a/c

To Patents a/c

To Other Assets a/c (given specific names)

7. If provision is made for any contingent liability, following Journal entry will be passed –

Capital Reduction a/c Dr.

To Contingent Liability a/c (given the specific name)

8. After writing-off the various losses with the 'Capital Reduction Account', if there is still some balance in the 'Capital Reduction Account', it should be transferred to 'Capital Reserve Account'. For this, the following Journal entry will be passed–

Capital Reduction a/c Dr.

To Capital Reserve a/c

A compound entry can also be made for the above mentioned items (vi), (vii) and (viii). Under the 'Capital Reduction Scheme', if new shares are issued and call money is demanded from old shareholders and the amount so received is used for the purchase of some new assets, the transactions will be recorded in the books of the company by Journal entries according to the general rules.